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ARTICLES

NOTE

CASE COMMENTS

STATUTORY COMMENTARY

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The Georgetown Law Journal
Volume 71 Number 4 April 1983

CONTENTS

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The Georgetown Law Journal

Volume 71 Number 4 April 1983

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Creeping Xenophobia and the Taxation of Foreign-Owned Real Estate*

RICHARD L. KAPLAN**

Prior to 1980 certain nonresident alien individuals and foreign corporations were exempt from United States tax on their United States source capital gains that were not effectively connected with the conduct of a trade or business within the United States. Congress enacted the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) to close this perceived loophole to the extent that it exempted gains derived from sales of United States real estate. In this article Professor Kaplan analyzes the pre-FIRPTA tax regime and the modifications introduced by FIRPTA. Professor Kaplan argues that the loophole addressed by FIRPTA not only was of minor significance, but was consciously created because of the difficulty of collecting taxes on the capital gains of nonresident, nonbusiness foreign investors, and was justifiable on additional policy grounds. In partially closing this limited loophole, FIRPTA complicates the tax code, overrides bilateral tax treaty provisions, and creates an intrusive but unenforceable collection scheme. Professor Kaplan suggests that FIRPTA can only be understood as an attempt to discourage foreign investment in United States real estate—a xenophobic goal, lacking any economic or common sense rationale, which FIRPTA is in any case unlikely to accomplish—and recommends that FIRPTA be repealed in its entirety.

TABLE OF CONTENTS

** Associate Professor of Law, University of Illinois. B.S. 1970, Indiana University; J.D. 1976, Yale University. The author gratefully acknowledges the helpful comments of Professors Stanley S. Surrey and Elisabeth A. Owens of the Harvard Law School on an earlier draft of this article.

I. INTRODUCTION

For many years the subject of foreign ownership of United States property was the concern primarily of international investment advisors and economic theorists. In the decade of the 1970's, however, this arcane topic became the focus of widespread concern and intense debate.[1] The popular television news program, "60 Minutes," devoted an entire segment to foreign purchases of United States farmland, and the American Bar Association began sponsoring annual courses on foreign investment planning geared toward general practitioners, not just international law specialists.[2]

The increased attention given to foreign holdings of United States real estate is directly related to the perceived phenomenal expansion of such holdings in recent years.[3] International investors had long been attracted to United States investments because of the relative stability of this country's economic and political systems, as well as the sheer enormousness of the investment market itself.[4] But this attraction became even stronger in the 1970's because of favorable foreign currency fluctuations,[5] the rise of local communist movements overseas, and other destabilizing events. At the same time, skyrocketing petroleum prices concentrated more investable funds in the hands of some foreign investors than had ever been the case before.[6] By the end of 1980, in fact,

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1. *See, e.g.*, K. CROWE, AMERICA FOR SALE (1978); E. FRY, FINANCIAL INVASION OF THE U.S.A.: A THREAT TO AMERICAN SOCIETY? (1980), *reviewed in* Kaplan, Book Review, 129 U. PA. L. REV. 486 (1980); Lanier, *The New Kids on the Block*, CHICAGO, Apr. 1982, at 148; Rubin, *The Selling of California*, 9 CAL. J. 409 (1978); Samuelson, *Make Way—The Foreign Investors Are Coming*, 10 NAT'L J. 664 (1978); Drinkhall & Guyon, *Real-Estate Purchases By Foreigners Climb, Stirring Wide Debate*, Wall St. J., Sept. 26, 1979, at 1, col. 1; *Foreign Investors Flock to U.S. Farmlands*, BUS. WK., Mar. 27, 1978, at 79.

2. *See* 13 A.B.A.-A.L.I. CLE REVIEW No. 30, at 4 (1982).

3. *See* U.S. DEP'T OF THE TREASURY, TAXATION OF FOREIGN INVESTMENT IN U.S. REAL ESTATE 5-14 (1979) (although newspaper accounts indicate rapid growth in foreign investment in United States real property in 1970's, available statistics inadequate and conflicting) [hereinafter TREASURY REPORT].

4. *See* U.S. GEN. ACCOUNTING OFFICE, FOREIGN INVESTMENT IN U.S. AGRICULTURAL LAND—HOW IT SHAPES UP 68-80 (1979) [hereinafter GAO REPORT]; Katz, *Foreign Direct Investment in the United States—Advantages and Barriers*, 11 CASE W. RES. J. INT'L L. 473, 474-76 (1979).

5. *See* E. FRY, *supra* note 1, at 36 (during seven years ending in April 1978, dollar declined 63% against Japanese yen, 81% against German mark, and 131% against Swiss franc).

6. Observers estimated that surpluses held by Arab oil exporters could amount to $120 billion in 1980, up from $5.3 billion only two years earlier. *Arab Banks Grow*, BUS. WK., Oct. 6, 1980, at 70, 72; Paul, *Arabs Buying Up U.S.? For Now, at Any Rate, They Aren't Interested*, Wall St. J., Aug. 18, 1980, at 1, col. 6.

the Arab oil exporting nations had invested $340 billion worldwide, a tripling of their cumulative investment since 1975, and fully 80% of this total came from just four countries: Iraq, Kuwait, Saudi Arabia, and the United Arab Emirates.[7]

These developments have not gone unnoticed or been unequivocally applauded. In 1974, for example, Congress asked the Department of Commerce to prepare a "benchmark" study of foreign investment in the United States,[8] and two years later, a nine-volume tome was completed.[9] Congress then responded with the International Investment Survey Act of 1976,[10] which requires the President to obtain information concerning foreign acquisitions of 10% ownership interests, whether direct or "indirect," in American businesses.[11] This Act provides penalties of up to $10,000 and imprisonment terms of up to one year for failure to report such acquisitions.[12] Thus, Congress created a mechanism to monitor foreign investment on an annual basis.

Although this Act purports to deal with all types of foreign investment, it is critically deficient with respect to real estate holdings. Such holdings need be reported only if they cost at least $1,000,000 or comprise at least 200 acres.[13] Even then, these acquisitions need not be reported if the land is being held "exclusively for personal use,"[14] which can include being leased to other parties in certain circumstances.[15] As a result of these exclusions, data were woefully inadequate on that apparently most sensitive of all foreign investments—United States farmland.[16]

To remedy this situation, Congress then enacted a new statute, the Agricultural Foreign Investment Disclosure Act of 1978.[17] This Act requires reports

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7. *Arab Banks Grow*, BUS. WK., Oct. 6, 1980, at 70, 73. *See generally* Kaplan, *International Economic Organizations: Oil and Money*, 17 HARV. INT'L L.J. 203 (1976) (advocating development of international institutions to deal with surplus funds being accumulated in OPEC nations); Lillich, *Economic Coercion and the International Legal Order*, 51 INT'L AFF. 358 (1975) (advocating new rules of international law providing equal access to raw materials and imposing sanctions on countries, such as OPEC nations, that use natural resources as economic weapons).

8. Foreign Investment Study Act of 1974, Pub. L. No. 93-479, 88 Stat. 1450.

9. 1-9 U.S. DEP'T OF COMMERCE, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES (1976). "Direct" investments require at least a 10% interest in the stock of a United States corporation. 3 *id.* at A-1.

10. Pub. L. No. 94-472, 90 Stat. 2059 (codified as amended at 22 U.S.C. §§ 3101-3108 (1976 & Supp. V 1981).

11. 22 U.S.C. § 3103 (1976 & Supp. V 1981); *id.* § 3102(8), (10) (1976). The Act authorizes promulgation of regulations requiring persons to maintain and disclose relevant information. *Id.* § 3104(a), (b). This Act is administered by the Department of Commerce, which promulgated implementing regulations effective on January 1, 1979. Exec. Order No. 11,961, 3 C.F.R. 86 (1978), *as amended by* Exec. Order No. 12,013, 3 C.F.R. 147 (1978) (delegation to Department of Commerce); 15 C.F.R. §§ 806.1-.17 (1982) (implementing regulations).

12. *Id.* § 3105(a), (c).

13. *See* 15 C.F.R. § 806.15(j)(3)(i)(b), (c), (4)(b) (1982).

14. 15 C.F.R. § 806.8 (1982).

15. *Id.*

16. *See* U.S. GEN. ACCOUNTING OFFICE, FOREIGN OWNERSHIP OF U.S. FARMLAND—MUCH CONCERN, LITTLE DATA 39, 57, 60 (1978).

17. Pub. L. No. 95-460, 92 Stat. 1263 (codified at 7 U.S.C. §§ 3501-3508 (Supp. V 1981). Implementing regulations became effective on May 18, 1979. 7 C.F.R. §§ 781.1-.4 (1982). *See Agricultural Foreign Investment Disclosure Act Administration: Hearings on P.L. 95-460 Before the Subcomm. on Family Farms, Rural Development, and Special Studies of the House Comm. on Agriculture*, 96th Cong., 1st Sess. (1979). *See generally* Hendrickson, *The Agricultural Foreign Investment Disclosure Act of 1978. Don't Panic!*, 13 INT'L LAW. 407 (1979); Zagaris, *The Agricultural Foreign Investment Disclosure Act of 1978:*

of foreign ownership of "agricultural land," including land used in timber production,[18] and once again, substantial fines are provided to deter nonreporting.[19] As is the case with the International Investment Survey Act, however, the objective is simply more *information* about foreign investments. No attempt is made to limit or otherwise dissuade foreign investors from coming to this country.

The reaction to foreign investments at the state level, however, has not been so benign. Many states have statutes that significantly restrict, and in some instances actually prohibit, certain foreign investments, particularly in undeveloped real estate.[20] These provisions are not entirely recent phenomena, but interest in their enforcement has increased markedly in the last few years.[21] Although the constitutional validity of such statutes, particularly on equal protection clause grounds,[22] is somewhat unclear,[23] they continue to proliferate nonetheless. In any case, these restrictions are regularly circumvented by using domestic nominees, local banks or lawyers as trustees, domestic shell corporations, and similar devices.[24] Consequently, these statutes have had little impact on foreign investments in United States real estate.[25]

So it was in 1978 that opponents of such investments came to see the root of their dilemma in, of all places, the federal tax code. Senator Wallop of Wyo-

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How Will It Affect the Market in U.S. Real Estate?, 8 REAL EST. L.J. 3 (1979); Note, *Disclosure of Foreign Direct Investment in United States Agricultural Property*, 12 VAND. J. TRANSNAT'L L. 665 (1979).

18. 7 U.S.C. § 3508 (Supp. V 1981).

19. *See* 7 U.S.C. § 3502(a), (b) (Supp. V 1981) (penalties of up to 25% of fair market value of foreign investor's interest in parcel).

20. These provisions are compiled in 1 U.S. DEP'T OF AGRICULTURE, MONITORING FOREIGN OWNERSHIP OF U.S. REAL ESTATE 58-94 (1979); Committee on Foreign Investment in U.S. Real Estate, *Foreign Investment in U.S. Real Estate: Federal and State Laws Affecting the Foreign Investor*, 14 REAL PROP. PROB. & TRUST J. 1, 18-40 (1980). *See also* E. FRY, *supra* note 1, at 148-55 (providing less detailed compilation of these provisions); Note, *Regulation of Foreign Investment in U.S. Real Estate*, 33 TAX LAW. 586, 613-15 (1980) (summarizing state laws restricting foreign land ownership, limiting duration of ownership, and setting acreage limitations).

21. *Cf.* Frazier, *National Sentiment Against Land Holdings of Foreigners Strikes Chord in Oklahoma*, Wall St. J., July 7, 1980, at 13, col. 4 (state attorney general enforces state constitutional provision that prohibits foreign ownership of real estate, warning that "Idi Amin could be your next-door neighbor").

22. U.S. CONST. amend. XIV, § 1, cl. 2; *cf.* Terrace v. Thompson, 263 U.S. 197, 218-22 (1923) (state law prohibiting land ownership by foreigners who cannot or do not intend to become United States citizens does not violate equal protection clause because exclusion is reasonable in light of state's interest in quality and allegiance of its landowners).

23. *See* Fisch, *State Regulation of Alien Land Ownership*, 43 MO. L. REV. 407, 414-28 (1978) (doubtful that courts will invalidate state statutes regulating alien land ownership, although these statutes may violate equal protection and due process clauses and involve state intrusion into conduct of foreign affairs); Note, *supra* note 20, at 616-21 (arguing that state restrictions on alien land ownership do not violate equal protection or dormant commerce clauses nor intrude into conduct of foreign affairs). *See generally* J. NOWAK, R. ROTUNDA & J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 594-96 (1978) (reviewing cases considering whether state restrictions on aliens' access to limited resources violate equal protection clause).

24. *See* Morrison, *Limitations on Alien Investment in American Real Estate*, 60 MINN. L. REV. 621, 634-35 (1976) (most state restrictions easily avoided by conveyancing techniques, especially use of corporate forms); *see also* Bell & Savage, *Our Land in Your Land: Ineffective State Restriction of Alien Land Ownership and the Need for Federal Legislation*, 13 JOHN MARSHALL L. REV. 679, 691 (1980) (state restrictions usually overcome by use of corporate entities, inheritance laws, and trusts).

25. *See* U.S. GEN. ACCOUNTING OFFICE, FOREIGN OWNERSHIP OF U.S. FARMLAND—MUCH CONCERN, LITTLE DATA 5 (1978) (state laws ineffective at curbing foreign ownership of U.S. land).

ming introduced legislation[26] to close what came to be described as a "loophole"—namely, the longstanding exemption of certain foreign investors from tax upon the disposition of their capital assets,[27] including land. Although this amendment was withdrawn to give the Treasury Department time to study the problem,[28] it eventually culminated in the Foreign Investment in Real Property Tax Act of 1980,[29] commonly known as FIRPTA. The highly complex provisions of this statute were then amended by the Economic Recovery Tax Act of 1981[30] to "plug" further holes, and implementing regulations were first promulgated on September 21, 1982.[31] These enactments are the focus of this article, although many of the policy considerations discussed apply with equal force to the federal disclosure statutes and to the state prohibitions mentioned previously. Unlike those earlier manifestations of creeping xenophobia, however, these tax amendments are not essentially harmless. For reasons of tax complexity, international relations, and economic policy, this article argues, FIRPTA should be repealed in its entirety posthaste.

The article begins by describing the pre-FIRPTA tax regime to demonstrate that, contrary to popular belief, the "loophole" under attack was relatively small to begin with. It then examines the legislation that Congress enacted to counter this loophole and its effects on various planning techniques often employed by foreign investors. The article then focuses on two particularly critical aspects of this legislation: its deleterious effect on our bilateral tax treaty network and its basic unenforceability. The article then analyzes the policy considerations and economic ramifications of FIRPTA and of foreign real estate investments generally, concluding that FIRPTA is an ineffective solution to a nonexistent problem.

II. THE LIMITED LOOPHOLE OF THE PRE-1980 CODE

This section examines the taxation of income from investments in United States real estate by noncitizens, both alien individuals and foreign corporations,[32] independent of FIRPTA. That taxation depends upon a series of categories, each with its own rules. The first of these categories involves alien individuals who are "residents" of the United States. The second major category, persons engaged in a United States trade or business, can apply to aliens and foreign corporations alike. After examining these two categories, this sec-

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26. S. 3414, 95th Cong., 2d Sess., 124 CONG. REC. 26,140 (1978). The bill is reprinted as amendment 3988 to H.R. 13,511. 124 CONG. REC. at 34,604.

27. *See* I.R.C. §§ 864(c)(2), 871(a)(2), 881(a) (1976); Treas. Reg. §§ 1.871-7(d)(2)(ii), -8(b)(1) (1974); *id.* §§ 1.881-2(a)(1), 1.882-1(b)(2)(ii) (1973). *See generally infra* notes 32-87 and accompanying text (describing pre-1980 law).

28. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 553, 92 Stat. 2763, 2891. The study that resulted is TREASURY REPORT, *supra* note 3.

29. Pub. L. No. 96-499, §§ 1121-1125, 94 Stat. 2599, 2682 (adding or amending I.R.C. §§ 861(a)(5), 897, 6039C, 6652(g) (Supp. V 1981)).

30. Pub. L. No. 97-34, § 831, 95 Stat. 172, 352 (amending I.R.C. §§ 862(a), 897, 6039C (1976 & Supp. V 1981)).

31. Temp. Treas. Reg. §§ 6a.897-1 to 6a.897-4, 6a.6039C-1 to 6a.6039C-5, 47 Fed. Reg. 41,532 (1982). Additional regulations were promulgated on January 5, 1983. Temp. Treas. Reg. § 6a.6652(g)-1, 48 Fed. Reg. 647 (1983).

32. I.R.C. § 7701(a)(4), (5) (1976) (defining foreign corporation); Treas. Reg. § 301.7701-5 (1960) (same).

tion then analyzes the principal modifications made to this statutory regime by the network of bilateral tax treaties presently in force.

A. RESIDENCY

The threshold inquiry in the taxation of alien individuals is whether they are "residents" of the United States. Residents are treated like United States citizens;[33] that is, they are taxable by the United States on all of their income, "from whatever source derived."[34] Thus, any foreign investor who is a United States resident enjoys no preferred tax treatment vis-a-vis American citizens.

The term "resident" necessarily applies to foreigners who live in the United States full-time, but it is not limited to such persons. The key is the individual's intentions respecting his stay in this country. As the applicable regulations explain:

> An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. *A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient.* If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he has come has been consummated or abandoned.[35]

In applying this standard, the Internal Revenue Service presumes that an alien who has lived here one year is a resident, unless he proves otherwise.[36] Beyond this presumption, however, there are no fixed guidelines. One must consider all of the relevant facts and circumstances, such as the length and frequency of visits to the United States, the type of visa used, the existence of United States bank accounts, credit cards, drivers' licenses, country club memberships, social contacts, and the like.[37]

A foreigner's presence, moreover, need not be entirely volitional for him to be considered a resident. For example, an alien who comes to this country to

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33. Treas. Reg. § 1.1-1(b) (1974); *id.* § 1.871-1(a) (1980).

34. I.R.C. § 61(a) (1976). *See also* Cook v. Tait, 265 U.S. 47, 56 (1924) (United States citizens taxable by United States on income from foreign as well as domestic sources).

35. Treas. Reg. § 1.871-2(b) (1957) (emphasis added). *See, e.g.*, Park v. Commissioner, 79 T.C. 252 (1982) (Tongsun Park was United States resident because of his extensive involvement in commercial, social, and political affairs of this country).

36. *See* Rev. Rul. 69-611, 1969-2 C.B. 150.

37. Langer, *When Does a Nonresident Alien Become a Resident for U.S. Tax Purposes?*, 44 J. TAX'N 220, 222-23 (1976); *see also* Packman & Rosenberg, *How Foreigners (Unintentionally) Become U.S. Residents*, 57 TAXES 85 (1979) (detailed questionnaire for determining whether alien is a United States resident). *See generally* 3 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 65.2 (1981) (resident and nonresident aliens).

secure medical treatment that is not available elsewhere may become a resident, if the treatment in question makes an "extended stay" necessary.[38] Similarly, a foreign citizen who stayed in the United States because World War II made his return home precarious was a United States resident, notwithstanding his obvious inability to accelerate his departure.[39] Thus, a foreign investor who spends significant amounts of time in the United States, for whatever reason, may be classified as a United States resident and taxed accordingly.

B. TRADE OR BUSINESS

If the foreign investor is not a resident, or is a corporation—for which the question of residency does not apply—the next issue is whether that investor is engaged in a United States trade or business. Persons who are so engaged are taxed on any United States source income that is "effectively connected" to that trade or business.[40] Thus, this issue actually consists of four distinct elements, each of which must be present for the United States to impose tax: (1) United States source income (2) that is "effectively connected" (3) to a "trade or business" (4) that is carried on in the United States.

Respecting a real estate investor, the first requirement is clearly met. Rental income from United States land, developed or otherwise, is considered United States source income under the statutory sourcing rules.[41] Similarly, gains from the disposition of "real property located in the United States" are also United States source income.[42] And if the investor's real estate activities constitute a "trade or business," it seems clear that this "trade or business" is carried on in the United States.[43] Thus, the fourth requirement is usually satisfied as well.

Regarding the second requirement, that income be "effectively connnected," the rules are a bit more cryptic. The statute states only that, in making this determination, one must consider whether the income in question—here, rental receipts or profits from the sale of land—is "derived from assets used in or held for use in the conduct of [the taxpayer's] trade or business."[44] Thus, if a real estate investor's activities constitute a "trade or business," it seems likely that his rental income and sale profits will be considered "effectively connected" to that trade or business. The central question, therefore, is whether a foreign investor's real estate activities constitute a "trade or business." If so, all

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38. *See* Treas. Reg. § 1.871-2(b) (1957).

39. *See* Commissioner v. Nubar, 185 F.2d 584, 586-88 (4th Cir. 1950), *cert. denied*, 341 U.S. 925 (1951).

40. I.R.C. § 871(b) (Supp. V 1981) (nonresident alien individuals), *id.* § 882(a)(1) (foreign corporations).

41. *Id.* § 861(a)(4) (1976).

42. Prior to FIRPTA, the Code treated as United States source income gains from the "sale or exchange of real property located in the United States." I.R.C. § 861(a)(5) (1976) (pre-FIRPTA). FIRPTA broadened this definition. *See id.* §§ 861(a)(5), 897(c)(1)(A) (Supp. V 1981).

43. *Cf.* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 17-13 to 17-14 (4th ed. 1979) (discussing criteria for determining whether foreign corporation is engaged in United States trade or business).

44. I.R.C. § 864(c)(2)(A) (1976); *see also id.* § 864(c)(1)(A); *id.* § 871(a)(1); *id.* § 881(a). An alternative consideration is whether "the activities of such trade or business were a material factor in the realization" of the income or gain. *Id.* § 864(c)(2)(B).

four elements are present, and the investor is fully taxable on his United States real estate income.

1. Real Estate Ownership as a "Business"

Although the phrase "trade or business" is obviously of signal importance in this taxing regime, the Code provides no comprehensive definition.[45] Moreover, precedents from other statutory uses[46] of this rather ubiquitous phrase are not easily transferred to this context. That is not to say, however, that there are no clear instances of "trade or business" status. For example, a foreign investor who purchases vast quantities of land and subdivides them for resale as a regular practice, or who develops his land into office parks, apartment complexes, shopping centers, or warehouses, is engaged in a "trade or business."[47] But what if the foreign investor's involvement is more passive? Can his involvement nevertheless constitute a "trade or business" for tax purposes?

The leading case is the Tax Court's decision in *Lewenhaupt v. Commissioner*.[48] That case involved a 30-year-old Swedish count, Jan Casimir Eric Emil Lewenhaupt, and some California property he inherited from his great-grandfather, Serranus Clinton Hastings, the first Chief Justice of California and the namesake of a prominent law school there.[49] The property in question was rental real estate that was managed by the Count's second cousin, a LaMontagne, who was a licensed real estate broker in California. Count Lewenhaupt himself never handled any of the day-to-day details, having given LaMontagne a broad power of attorney to buy, sell, and lease the property, largely as he saw fit.[50] The court held that the activities of LaMontagne were those of an agent and should be attributed to Lewenhaupt, as principal, in determining whether Lewenhaupt was engaged in a "trade or business."[51]

The question then became how to classify the activities of LaMontagne as agent for Lewenhaupt. One of the parcels sold by LaMontagne had been "net leased," and under this arrangement, the lessee had paid all property taxes, utilities, insurance, repairs, and maintenance.[52] All LaMontagne needed to do, in other words, was pay the mortgage and monitor the lessee. His responsibili-

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45. *But see id.* § 864(b)(1) (certain personal services not exceeding $3,000 do not constitute a "trade or business"); *id.* § 864(b)(2) (same for trading in securities or commodities).

46. *See, e.g., id.* § 162(a) (deduction of ordinary business expenses), *id.* § 513(a) (1976) ("unrelated" business income of charitable organizations), *id.* § 1221(1) (capital asset definition), *id.* § 1402(c) (self-employment tax), *id.* § 7701(a)(26) ("trade or business" includes performance of functions of public office); *see also* Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430, 1438-40 (1980) (discussing meaning of "trade or business" under I.R.C. § 513(a)).

47. *See* Garelik, *What Constitutes Doing Business Within the United States by a Non-Resident Alien Individual or a Foreign Corporation*, 18 TAX L. REV. 423, 442-48 (1963) (foreign real estate investor engages in "trade or business" whenever he or his agent does more than merely collect rents); *cf.* 2 B. BITTKER, *supra* note 37, at ¶ 51.2.3 (real property of developer treated as stock-in-trade of his business).

48. 20 T.C. 151 (1953), *aff'd per curiam*, 221 F.2d 227 (9th Cir. 1955).

49. *Id.* at 152.

50. *Id.* at 153.

51. *Id.* at 162-63; *see also* de Amodio v. Commissioner, 34 T.C. 894, 904-06 (1960) (acts of local real estate agents attributed to principal in determining whether latter engaged in "trade or business"), *aff'd on other grounds*, 299 F.2d 623 (3d Cir. 1962); Schwarcz v. Commissioner, 24 T.C. 733, 739-40 (1955) (resident alien engaged in business of operating rental real estate through acts of his agents), *acq.* 1956-1 C.B. 5.

52. 20 T.C. at 155 (Modesto property).

ties respecting some other properties were a bit more involved, but the court made no effort to separate the various properties and found instead that LaMontagne's activities, taken as a whole, constituted being engaged in a real estate business. In what has become the classic formulation of the "trade or business" test, the court declared that LaMontagne's activities were "*beyond the scope of mere ownership* of real property, or the receipt of income from real property. *The activities were considerable, continuous, and regular* and, in our opinion, constituted engaging in a business."[53]

The question for real estate investors, therefore, is what constitutes the "mere ownership" of real estate, because the activities categorized in *Lewenhaupt* as a "business" were largely stewardship chores: collecting rents, keeping records, supervising repairs, paying mortgages, and so forth.[54] How can anyone really get by with much less? Thus, the phrase "trade or business" seems quite expansive in a real estate context. On the other hand, the Service has ruled that merely receiving rent from net leased property does not constitute a "trade or business."[55] Similarly, investors who own undeveloped land and do nothing with it are not considered to be engaging in business activities.[56] Nevertheless, the *Lewenhaupt* decision and its progeny[57] suggest rather strongly that many foreign investors probably are engaging in a "trade or business." Accordingly, their real estate profits are already taxable without regard to FIRPTA.

2. Significance of Nonbusiness Status

Even if a foreign investor manages to avoid "trade or business" status, he is not necessarily exempt from United States taxation. Investors who are not engaged in a "trade or business" are still subject to a United States tax of thirty percent on gross income from their "fixed or determinable" sources, including rent receipts.[58] But gains from the disposition of capital assets, such as land, are exempt from United States tax—at least if the investor is a foreign corporation.[59] If the investor is an alien individual, his tax treatment depends on whether he was "present in the United States" at least 183 days during the year of disposition.[60] If so, he is taxed at thirty percent of the capital gain realized.[61]

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53. *Id.* at 163 (emphasis added).

54. *See id.* Additional activities included executing leases, executing an option to purchase one property, and selling another property. *Id.*

55. Rev. Rul. 73-522, 1973-2 C.B. 226; *see also* Herbert v. Commissioner, 30 T.C. 26, 33 (1958) (nonresident alien did not engage in "trade or business" when she rented her only property under long-term lease that gave the lessee complete control of building and responsibility for all repairs except to outer walls and foundation); Neill v. Commissioner, 46 B.T.A. 197, 198 (1942) (nonresident alien did not engage in "trade or business" when she rented her only property under long-term lease requiring lessee to pay taxes and insurance and to maintain property).

56. *Cf.* Whipple v. Commissioner, 373 U.S. 193, 202 (1963) (personal investing not a "business").

57. *See, e.g.,* de Amodio v. Commissioner, 34 T.C. 894, 904-06 (1960) (nonresident alien engaged in "trade or business" when his agents negotiated leases, arranged for repairs, collected rents, and paid taxes), *aff'd on other grounds*, 299 F.2d 623 (3d Cir. 1962).

58. I.R.C. § 871(a)(1)(A) (1976) (nonresident alien individuals), *id.* § 881(a)(1) (foreign corporations).

59. Treas. Reg. § 1.881-2(a)(1) (1973).

60. I.R.C. § 871(a)(2) (1976). Only time spent by the foreign investor himself counts in this computation; an agent's time is not attributed. Treas. Reg. § 1.871-7(d)(2)(iii) (1974).

61. I.R.C. § 871(a)(2) (1976).

If not, his gain is free of United States tax.[62] And that is the Great Loophole: a foreign corporation that is not engaged in a United States trade or business may receive capital gains tax-free; an alien individual may do likewise if he is not (a) a resident, (b) engaged in a United States trade or business, *or* (c) in the United States more than 182 days in the year of sale. Among loopholes, this one is hardly of the gaping variety, but for foreign investors seeking tax-free capital gains, it is the route provided.

Some foreign investors, however, will find this "loophole" unappealing because of the thirty percent tax on *gross* income. Such a tax might be a serious problem for owners of developed properties, particularly if the net cash flow from the project is less than the amount of this tax. To such persons, the status of being engaged in a "trade or business" might be more attractive, because they would then be taxed—at the regular rates—on their *net* income after claiming all available deductions.[63] Thus, when operating earnings, and not just disposition gains, are a factor, "trade or business" status might actually be the preferable classification.

To take an example, assume that a foreign corporation buys an office building that is net leased for $100 annually and incurs interest expense of $40 and depreciation of $50 during this period. Its tax under "business" and "nonbusiness" classifications would be calculated as follows:

	Business	Nonbusiness
Gross Rental Receipts	$100	$100
Expenses: Interest[64]	(40)	
Depreciation[65]	(50)	
Net Income	$ 10	
Tax Due[66]	$ 4.6	$ 30

The results will vary, of course, with the applicable tax bracket and with the extent of the deductible expenses incurred, but the point remains that in many cases a foreign investor actually will prefer "trade or business" status.

There are, however, two distinct problems that arise in claiming such status. First, if the investor claims that he is engaged in a "trade or business," he effectively "closes" the capital gain loophole, and any gain upon disposition of the property will be taxable by the United States.[67] Second, the Service might challenge the investor's claim and try to impose the thirty percent tax on gross rental income on the ground that the investor was not engaged in a "trade or

62. Treas. Reg. § 1.871-7(d)(2)(ii) (1974).

63. I.R.C. §§ 871(b)(1), 873(a), 882(a)(1), (c)(1)(A) (1976 & Supp. V 1981).

64. *See id.* § 163(a) (1976) (allowing deduction for interest paid or accrued within taxable year on indebtedness).

65. *See id.* § 167(a) (Supp. V 1981) (allowing depreciation deduction); *id.* § 168(a) (added by Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 201(a), 95 Stat. 172, 203) (adopting Accelerated Cost Recovery System for depreciation of property placed in service after Dec. 31, 1980).

66. *See id.* § 11(b)(5) (marginal tax rate of 46% on taxable corporate income over $100,000); *id.* § 882(a)(1) (section 11 applies to foreign corporate income connected with United States business). The example in text assumes that the $10 net income from the office building is in addition to other taxable income totaling at least $100,000.

67. *Id.* §§ 864(c)(2), 871(b)(1), 882(a)(1) (1976 & Supp. V 1981).

business."[68] Congress mollified this latter problem somewhat in 1966 when it created a statutory election for foreign investors in United States real estate.[69] Under this provision, the investor may affirmatively elect "trade or business" status and thereby become entitled to all deductions available to domestic taxpayers.[70] There is, however, a catch. Once an election has been in effect for three years, the investor can revoke it only by securing the Commissioner's consent.[71] Such consent seems highly unlikely if the investor plans to dispose of the property, because any gain realized upon that disposition might thereby become tax-exempt. In many instances, of course, the foreign investor would still be better off overall with the "trade or business" classification, but loss of the tax exemption on disposition gains is a high price to pay. All of which suggests that the "loophole" is effectively even smaller than it at first appears because of the tax imposed on nonbusiness gross income. At least, that is, until tax treaty provisions are considered.

C. TAX TREATY MODIFICATIONS

The United States is a party to some forty-two tax treaties with other nations, many of which also apply to other jurisdictions, such as former colonies of the treaty signatory.[72] These treaties are renegotiated and amended from time to time and generally take precedence over conflicting provisions in the United States tax code,[73] at least with respect to residents of signatory countries.[74] Thus, there is not just one taxing regime for foreign investors; there are several. Most of the tax treaties, however, do conform to a "model" United

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68. *See* Abegg v. Commissioner, 429 F.2d 1209, 1211 n.1 (2d Cir. 1970) (sustaining Commissioner's challenge to taxpayer's claim of "trade or business" status), *cert. denied*, 400 U.S. 1008 (1971); Continental Trading, Inc. v. Commissioner, 265 F.2d 40, 41, 43 (9th Cir.) (same), *cert. denied*, 361 U.S. 827 (1959).

69. Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, §§ 103(a)(1), 104(b)(1), 80 Stat. 1539, 1547, 1555 (adding and amending I.R.C. §§ 871(d), 882(d) (1976)).

70. I.R.C. § 871(d) (1976) (election by nonresident alien individual), *id.* § 882(d) (election by foreign corporation).

71. *See id.* § 871(d)(3) (1976) (revocation by nonresident alien individual), *id.* § 882(d)(1) (revocation by foreign corporation), *id.* § 6511(a) (taxpayer must file claim for credit or refund of overpayment of tax within three years from time return was filed); Treas. Reg. § 1.871-10(d)(1)(i),(2)(i) (1974). Following such revocation, an election cannot be made for five years unless the Commissioner's consent is obtained. I.R.C. § 871(d)(2) (1976) (election after revocation by nonresident alien individual), *id.* § 882(d)(2) (election after revocation by foreign corporation).

72. *See* 4 R. RHOADES & M. LANGER, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS (1981) (texts of all current United States tax treaties); 1-2 TAX TREATIES (CCH) (same). For background and overviews of U.S. tax treaties, see generally J. BISCHEL & R. FEINSCHREIBER, FUNDAMENTALS OF INTERNATIONAL TAXATION 203-13 (1977); 3 B. BITTKER, *supra* note 37, ¶ 66.8; P. MCDANIEL & H. AULT, INTRODUCTION TO UNITED STATES INTERNATIONAL TAXATION 167-80 (2d ed. 1981); P. POSTLEWAITE, INTERNATIONAL CORPORATE TAXATION 60-78 (1980); 3 R. RHOADES & M. LANGER, *supra*; Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428 (1963); Surrey, *International Tax Conventions: How They Operate and What They Accomplish*, 23 J. TAX'N 364 (1965); Trelles, *Double Taxation, Fiscal Evasion, and International Tax Treaties*, 12 IND. L. REV. 341 (1979).

73. *See* I.R.C. § 894 (a) (1976) ("[i]ncome of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle"); *see also id.* § 7852(d) (inapplicability of Code provisions contrary to United States treaty obligations in effect on date of enactment).

74. *See infra* notes 82-87 and accompanying text (discussing use of corporations formed in signatory countries by nontreaty country investors to obtain benefits of those tax treaties).

States tax convention,[75] to a greater or lesser degree, and some general observations about these treaties, therefore, are possible.

With regard to foreign investments in United States real estate, tax treaties have their greatest impact on the pivotal question of an investor's "trade or business" status. Some of the treaties ease the gross income tax/loss of capital gain exemption dilemma described above[76] by reducing the tax rate on rental receipts to fifteen percent,[77] but the more significant change concerns the election to be treated as a business and taxed on one's net income. Unlike the statutory versions of this election,[78] the treaty elections usually apply only to the year of their election.[79] Thus, when an investor anticipates sizeable deductions, he can use the treaty election to ensure that those deductions will offset his rental income. And in the year of the property's disposition, he can simply choose *not* to make an election—without needing anyone's permission to change status[80] —and secure a tax-free capital gain. These treaties, therefore, substantially ameliorate the dilemma posed by the "trade or business" rules with respect to income-producing real estate.[81]

Theoretically, tax treaties apply only to transactions involving residents of the signatory countries. All other investors are limited to the statutory provisions already analyzed.[82] But in practice the lot of investors from nontreaty countries is not quite so bleak. The vast literature[83] on planning foreign invest-

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75. *See* U.S. DEPT. OF THE TREASURY, MODEL CONVENTION ON INCOME TAXES (1981), *reprinted in* 3 R. RHOADES & M. LANGER, *supra* note 72, § 15.09; 1 TAX TREATIES (CCH) ¶ 158.

76. *See supra* notes 58-71 and accompanying text.

77. *See* INTERNAL REVENUE SERVICE, WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS 16-17 (Pub. No. 515, 1980), *reprinted in* 2 R. RHOADES & M. LANGER, *supra* note 72, at A-16 to A-17; *see also* TREASURY REPORT, *supra* note 3, at 28-29 (reprinting table). This benefit is typically restricted to investors without "permanent establishments" in this country. *See* TREASURY REPORT, *supra* note 3, at 28-29 n.h. A "permanent establishment" is analogous to the Code's concept of a "trade or business" and is usually defined as a "fixed place of business through which a resident of one of the [signatory countries] engages in industrial or commercial activity." Convention for the Avoidance of Double Taxation, Dec. 3, 1971, United States-Norway, art. 4(1), 23 U.S.T. 2832, 2838, T.I.A.S. No. 7474 [hereinafter Norwegian Treaty]. For further discussions of the "permanent establishment" concept, see P. POSTLEWAITE, *supra* note 72, at 66-70; 3 R. RHOADES & M. LANGER, *supra* note 72, § 10.02; Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277 (1976).

78. *See* I.R.C. § 871(d) (1976) (election by nonresident alien individuals), *id.* § 882(d) (election by foreign corporations).

79. *See, e.g.,* Convention with Respect to Taxes on Income and Property, July 28, 1967, United States-France, art. 5(3), 19 U.S.T. 5280, 5289, T.I.A.S. No. 6518, *modified by* Protocol, Oct. 12, 1970, 23 U.S.T. 20, T.I.A.S. 7270 [hereinafter French Treaty]; Convention for the Avoidance of Double Taxation, July 22, 1954, United States-Germany, art. IX(2), 5 U.S.T. 2768, 2788, T.I.A.S. No. 3133, *modified by* Protocol, Sept. 17, 1965, 16 U.S.T. 1875, T.I.A.S. No. 5920 [hereinafter German Treaty]; Convention with Respect to Taxes on Income, Apr. 29, 1948, United States-Netherlands, art. X, 62 Stat. 1757, 1762, T.I.A.S. No. 1855, *as supplemented by* Protocol, June 15, 1955, 6 U.S.T. 3696, T.I.A.S. No. 3366, *as modified and supplemented by* Exchange of Notes, June 24-Nov. 10, 1955, 6 U.S.T. 3703, T.I.A.S. No. 3367, *as modified and supplemented by* Protocol, Oct. 23, 1963, 15 U.S.T. 1900, T.I.A.S. No. 5665, *as modified and supplemented by* Convention, Dec. 30, 1965, 17 U.S.T. 896, T.I.A.S. No. 6051 [hereinafter Netherlands Treaty]; Convention for the Avoidance of Double Taxation, May 24, 1951, United States-Switzerland, art. IX(2), 2 U.S.T. 1751, 1758, T.I.A.S. No. 2316.

80. *Cf. supra* note 71 and accompanying text (discussing revocation of election under Internal Revenue Code).

81. *See generally* Hollingsworth & Banks, *Foreign Investment in U.S. Real Estate: An Analysis of Code-Treaty Interaction*, 52 J. TAX'N 38 (1980).

82. *See supra* notes 33-71 and accompanying text.

83. *See, e.g.,* R. BARAK, FOREIGN INVESTMENT IN U.S. REAL ESTATE (1981); M. LANGER, PRACTICAL INTERNATIONAL TAX PLANNING (1979); Feinschreiber & Feinschreiber, *Foreign Investment in U.S. Real Estate: The Federal Tax Considerations*, 3 REAL EST. L.J. 144 (1974); Forry, *Planning Investments*

ments customarily recommends the use of corporations formed in jurisdictions with favorable tax treaties as vehicles for such investments.[84] Accordingly, even investors from nontreaty countries—particularly those from the Middle East and Latin America—can obtain the benefits of tax treaties by investing through corporations formed in the Netherlands Antilles[85] or other favored locales.[86] Although this use of tax treaties by third-country investors is extremely controversial,[87] the practice remains widespread, if not commonplace. The indisputable consequence, therefore, of our bilateral tax treaty network is the effective enlargement of the Code's capital gain loophole through the annual "trade or business" elections these treaties provide.

III. THE CONGRESSIONAL RESPONSE OF 1980 AND 1981

As the preceding section has shown, the ability of some foreign investors to avoid tax on their United States real estate gains results primarily from the statutory requirement that such gains be derived from a "trade or business" in order to be subject to United States tax. This, then, is the rule that FIRPTA and its subsequent amendments had to address. Doing so, however, was not as straightforward as it might seem, and this section begins by examining the definitional changes required. It then analyzes the effect of these changes on the more commonly employed arrangements exploiting the previous statutory lacuna.

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from Abroad in United States Real Estate, 9 INT'L LAW. 239 (1975); Klein, *Investments by Foreign Persons in United States Real Estate*, 2 J. REAL EST. TAX'N 265 (1975); Knight, *Planning for Foreign Investments in U.S. Real Estate*, 36 N.Y.U. INST. FED. TAX'N 1081 (1978); McDonald, *Income Tax Planning for the Nonresident Alien Investor*, 31 S. CAL. TAX INST. 743 (1979); Schulweis, *Foreign Investments in United States Real Estate*, 38 N.Y.U. INST. FED. TAX'N ch. 15 (1980).

84. *See, e.g.*, R. BARAK, *supra* note 83, at 86-110; M. LANGER, *supra* note 83, at 111-80; Vogel, Bernstein & Nitsche, *Inward Investments in Securities and Direct Operations Through the British Virgin Islands: How Serious a Rival to the Netherlands Antilles Island Paradise?*, 34 TAX L. REV. 321 (1979).

85. *See* Amador, *Investment in Tax Sheltered U.S. Realty Through the Netherlands Antilles*, 28 TAX EXEC. 175 (1976); Forty, *supra* note 83, at 247-49; Kanner, *Advising the Foreign Investor in U.S. Real Estate: The Netherlands Antilles Corporation*, 8 REAL EST. L.J. 64 (1979); *see also Taxation of Foreign Investment in the United States: Hearing on S. 192 and S. 208 Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance*, 96th Cong., 1st Sess. 36 (1979) (chart showing tax advantages of investing through a Netherlands Antilles corporation).

86. *See generally* W. DIAMOND & D. DIAMOND, TAX HAVENS OF THE WORLD (1978); A. STARCHILD, TAX HAVENS FOR CORPORATIONS (1979).

87. *See generally* R. GORDON, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS—AN OVERVIEW 147-79 (1981); Brockway, *The U.S. Tax Treaty Program: Major Issues and Options*, 11 TAX NOTES 907 (1980) (questioning whether national interest served by having treaties with international tax havens); Langer, *The Need for Reform in the Tax Treaty Area*, 3 REV. TAX'N INDIVIDUALS 99 (1979) (recommending that Congress override treaty provisions if necessary to eliminate abuses of treaty-shopping); Note, *Renegotiation of the United States-British Virgin Islands Tax Convention: Prelude to the End of Treaty Shopping?* 22 VA. J. INT'L L. 381 (1982) (recommending that tax treaties with tax havens be renegotiated to include tougher information exchange and anti-holding company provisions). In March 1982 the Treasury Department proposed amending the United States Model Tax Treaty to limit the benefits of tax treaties to bona fide residents of signatory nations. *See* Kaplan, *The Shoppable Treaty: Should It Become Extinct?*, TAX MGMT. INT'L J., June 1982, at 3; *see also* Fialka, *Corporate Tax Haven in Netherlands Antilles Is Bracing for a Disaster*, Wall St. J., Oct. 11, 1982, at 1, col. 6 (tracing history of Netherlands Antilles as tax haven and reporting possibility that its tax treaty may soon be cancelled).

A. DEFINITIONAL CHANGES

When Congress enacted FIRPTA, it chose not to disturb the basic rule that capital gains are taxable only when "effectively connected" with a United States "trade or business."[88] Instead, FIRPTA supplies the rule's condition precedent by statutory fiat. Thus, the gain

> of a nonresident alien individual or a foreign corporation from the disposition of a United States real property interest shall be taken into account . . . *as if* the taxpayer were engaged in a trade or business within the United States during the taxable year and *as if* such gain . . . were effectively connected with such trade or business.[89]

In other words, there no longer is any need to consider the extent of an investor's involvement in his property's operation, or the scope of that troublesome phrase, "trade or business." If the gain results from a "United States real property interest," it is treated *as if* it were "effectively connected" income and is taxed at the rates applicable to domestic taxpayers.[90]

The pivotal element in this regime, obviously, is the newly created term of art, "United States real property interest." This phrase is defined as any "interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands."[91] Moreover, FIRPTA recognizes that an investor can profit from real estate without actually owning it and accordingly includes as a "real property interest" all "leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon."[92] Clearly, the new statute reaches far beyond fee simple ownership of undeveloped land, encompassing even a humble option to lease an apartment or a small storefront. Such comprehensiveness is not unusual in legislation that responds to perceived "abuses,"[93] but the inevitable result is

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88. I.R.C. §§ 864(c)(1)(A), (2), 871(b)(1), 882(a)(1) (1976 & Supp. V 1981).

89. *Id.* § 897(a)(1) (Supp. V 1981) (added by Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1122(a), 94 Stat. 2599, 2682) (emphasis added). For analyses of the technical aspects of these amendments, see Feder & Parker, *The Foreign Investment in Real Property Tax Act of 1980*, 34 TAX LAW. 545 (1981); Hudson, *Capital Gain Taxation of Foreigners' Investments in U.S. Real Property*, 67 A.B.A. J. 1366 (1981); Klein, *An Analysis of the Foreign Investment in Real Property Tax Act of 1980: How It Works*, 54 J. TAX'N 202 (1981); Mihaly, *Tax Treatment of Gains Realized by Foreigners on Sale of U.S. Real Property*, 16 INT'L LAW. 95 (1982); Newton, *Tax Planning: Foreign Investment in United States Real Property*, 12 GA. J. INT'L & COMP. L. 1 (1982); Nihill, *Foreign Investment in Real Property Tax Act of 1980—Part II: An Analysis*, 8 J. REAL EST. TAX'N 301 (1981); Pedersen & Sharp, *Real Estate Investments by Foreign Persons After the Foreign Investment in Real Property Tax Act of 1980*, 11 REAL EST. L.J. 47 (1982). *See generally* W. KNIGHT, STRUCTURING FOREIGN INVESTMENT IN U.S. REAL ESTATE (1982).

90. *See* I.R.C. §§ 11, 55, 871(b)(1), 882(a)(1), 897(a)(1), 1201(a) (P-H 1982). *But see id.* § 897(a)(2) (modification of minimum tax on tax preferences as applied to nonresident aliens).

91. *Id.* § 897(c)(1)(A)(i) (Supp. V 1981).

92. *Id.* § 897(c)(6)(A); *see also id.* § 897(c)(6)(B) (real property includes personal property, such as furnishings, that is "associated with the use of real property").

93. *Cf.* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §§ 501, 503, 95 Stat. 172, 323, 327 (adding I.R.C. §§ 1092, 1256 (Supp. V 1981), dealing with "abusive" commodity straddles). On the relationship of tax avoidance arrangements to legislative reaction generally, see Cooper, *The Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics, and Tax Reform*, 80 COLUM. L. REV. 1553 (1980); *see also* Bittker, *Tax Shelters for the Poor?*, 51 TAXES 68 (1973).

that FIRPTA affects transactions that are not typically thought of as real estate deals.

FIRPTA also addresses the common situation in which real estate is held by a corporation with the foreign investor owning stock in that corporation but not the real estate itself. To counter the circumvention possibility created by such an arrangement, FIRPTA defines "real property interest" to include "any interest (other than an interest solely as a creditor) in any domestic corporation . . . ."[94] Thus, stock in a domestic corporation, or a loan to a company in which the investor also holds stock, is a "real property interest." In applying this seemingly straightforward definition, however, practitioners must grapple with one of the most intractable issues in the law of corporate taxation—namely, whether an interest in a corporation is stock or debt.[95] Comprehensive regulations have been proposed on this subject,[96] but they expressly disclaim application to international transactions, including the issuance of stock to foreign persons.[97] Thus, foreign investors are left largely to fend for themselves in what is a particularly murky quagmire.

Be that as it may, the broad inclusion of corporate stock as "real property interests" is subject to two important exceptions. The first exception covers stock that is "regularly traded on an established securities market," unless the investor holds more than five percent of that company's stock.[98] Although there is no theoretical basis for distinguishing private and public companies, practical necessity—particularly the extensive turnover of public stock holdings—may have mandated this limitation. In any case, this exception means that most investors in Exxon Corporation, for example, are not affected by FIRPTA, even though Exxon has vast holdings of United States real estate.

The second exception applies to stock of a corporation that was not a "United States real property holding corporation" during the period in which the foreign investor held its stock.[99] A "United States real property holding corporation" is defined as any corporation whose "United States real property interests" comprise at least fifty percent of its real property interests, including foreign holdings, plus any other assets that are used or held for use in a "trade

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94. I.R.C. § 897(c)(1)(A)(ii) (Supp. V 1981).

95. *See* Temp. Treas. Reg. § 6a.897-1(d)(4)(i) (1982) (for purposes of § 897, interest in corporation other than solely as creditor is "interest which is or would be treated as stock of such corporation under any principle of federal income taxation"). *See generally* Kaplan & Yoder, *New Variations on an Old Enigma: The Treasury Department's Debt-Equity Regulations*, 1981 U. ILL. L. REV. 567 (discussing intractability of debt-equity dichotomy). The significance of the debt-equity distinction generally is analyzed in Kaplan & Yoder, *supra*, at 570-78.

96. Prop. Treas. Reg. §§ 1.385-0 to 1.385-8, 47 Fed. Reg. 164 (1982). For an extended critique of these proposed regulations, see Kaplan & Yoder, *supra* note 95, at 584-623. Regarding the continuing controversy that has forestalled final implementation of these regulations, see Kaplan, *The Debt-Equity Debate: Stupefaction by Sloganeering*, 16 TAX NOTES 963 (1982) (attributing delay to criticism of proposed regulations as excessively complex and inhibitive of small business capital formation).

97. Prop. Treas. Reg. § 1.385-1(b)(3) (1982). The application of these regulations to international transactions is still being studied by the Treasury Department. *See* 47 Fed. Reg. 164 (1982).

98. I.R.C. § 897(c)(3) (Supp. V 1981).

99. *Id.* § 897(c)(1)(A)(ii)(I) (considering only the period after June 18, 1980 to be relevant). After June 18, 1985, the test will be whether the corporation was a "United States real property holding corporation" during the past five years, or during the period in which the investor held the corporation's stock, whichever is shorter. *See id.* § 897(c)(1)(A)(ii)(II). *But see id.* § 897(a)(1)(B) (special exception for certain companies holding no real estate interests at the time of disposition and which recognized any gains that were realized during the testing period described previously).

or business."[100] Thus, the exception would not apply to a company whose principal function is to own or develop United States real estate. Moreover, the statute requires that market values, not actual costs, be used in making this calculation.[101] Consider, for example, a company with the following assets:

	Market Value
United States Land (or stock of real estate holding companies)	$ 40,000
Foreign Land	50,000
Business Equipment	10,000
Total	$100,000

This company would not be a "United States real property holding corporation," because the value of its United States real estate is less than 50% ($40,000/$100,000 = 40%) of its real estate and other business holdings. On the other hand, had the United States land been appraised at $65,000 rather than $40,000, the company's total holdings would be $125,000 ($65,000 + $50,000 + $10,000), of which 52% ($65,000/$125,000) would consist of United States real estate. In that case, the statute's second exception would not be available, and stock in this corporation would be a "real property interest."[102]

Such piercing of the corporate veil,[103] though a bit convoluted, is certainly sound conceptually. If real estate is the object of FIRPTA's concern, real estate held in corporate form must be attributed to the corporation's foreign investors or else the statute would be virtually meaningless. The statute's use of fair market values, however, imposes an unavoidably speculative character on this rather central definition. Appraisals of real estate often vary considerably, depending upon the valuation methodology used and the purpose for which the appraisal is being prepared.[104] The example given above, in which land was valued alternatively at $40,000 and $65,000, is not unusual. Of course, the valuation problem is irrelevant when the corporation holds *only* real estate, as is often the case. But if a company's holdings are more diverse, ascertaining its status as a "United States real property holding corporation" with any degree of confidence may be quite difficult.

In any case, investors cannot avoid that status by concocting intricate holding structures because FIRPTA contains an impressive battery of "look-through" provisions in its arsenal. If, for example, a corporation owns a "controlling interest" in a subsidiary corporation, the assets of that subsidiary are imputed pro rata to the parent in determining the parent's status as a "United

100. *Id.* § 897(c)(2).

101. *Id.*

102. *Id.* § 897(c)(1)(A)(ii), (2). *See generally* Treas. Reg. § 6a.897-2 (1982) (entitled, "Establishing that a corporation is not a United States real property holding company").

103. *See also* I.R.C. § 897(g) (Supp. V 1981) (sale of interest in partnership, trust, or estate treated as sale of that entity's real estate interests).

104. For background and general discussion of real estate appraisal methodologies, see AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE (7th ed. 1978); E. RAMS, RAMS' REAL ESTATE APPRAISING HANDBOOK (1975); G. SMITH, MASTER GUIDE TO REAL ESTATE VALUATION (1973). Cynics sometimes attribute the phenomenon of widely varying appraisals to the fact that the appraisals are "Made As Instructed," parodying the professional appraiser's designation, MAI, which signifies that the appraiser is a "Member of the Appraisal Institute."

States real property holding corporation."[105] Moreover, this piercing of the corporate veil of tiers continues "successively" through the corporate hierarchy.[106] Similarly, real estate holdings of a partnership, trust, or estate are "treated as owned proportionately by its partners or beneficiaries."[107]

The statute's comprehensiveness finds further expression in its definition of a "controlling interest." A "controlling interest" requires only fifty percent stock ownership,[108] a standard that is significantly lower than the customary eighty percent threshold applied in most corporate control contexts.[109] Moreover, this definition is augmented by that great enemy of circumvention schemes, the stock attribution rules of section 318(a),[110] which are incorporated and even expanded upon in this setting.[111] The statute's point seems clear: formalities of title holding are irrelevant, whether they involve foreign or domestic corporations,[112] partnerships, or other conduits.[113] A company's status as a "United States real property holding corporation" is a function of its substantive asset ownership and nothing else.[114]

B. EFFECT ON TAX AVOIDANCE ARRANGEMENTS

With its broad definition of "real property interests" and its declaration that gains from such interests are "effectively connected" business income, FIRPTA makes irrelevant those arrangements that attempt to elude "trade or business" status. Net leases, for example, are no longer helpful from a tax standpoint, because even totally uninvolved investors are now taxable on their real estate profits. Similarly, it is pointless to use an annual tax treaty election[115] to obtain "trade or business" status in some years but not in others, because any gain upon disposition is now taxable without regard to such status.

Another avoidance maneuver consigned to the tax planner's junkheap involved the section 453 installment sale election. A foreign investor engaged in a trade or business might sell his real estate and arrange for the bulk of the

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105. I.R.C. § 897(c)(5)(A)(i)-(iii) (Supp. V 1981); *see also* Temp. Treas. Reg. § 6a.897-1(f) (1982) (imputing ownership of assets to shareholders, partners, or beneficiaries).

106. I.R.C. § 897(c)(5)(A) (Supp. V 1981).

107. *Id.* § 897(c)(4)(B); *see* Temp. Treas. Reg. § 6a.897-2(h) (1982).

108. I.R.C. § 897(c)(5)(B) (Supp. V 1981); *see* Temp. Treas. Reg. § 6a.897-2(i) (1982).

109. *See* I.R.C. § 351(a) (1976 & Supp. V 1981) (corporate organizations) *id.* § 368(c) (mergers and other tax-free reorganizations), *id.* § 1504(a) ("affiliated groups" filing consolidated returns).

110. *Id.* § 318(a) (1976). For discussion of the intricacies and complexities of section 318(a), see generally B. BITTKER & J. EUSTICE, *supra* note 43, at 9-12 to 9-18; W. PAINTER, CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS 264-69 (2d ed. 1981); Ringel, Surrey & Warren, *Attribution of Stock Ownership in the Internal Revenue Code*, 72 HARV. L. REV. 209 (1958). Professor Painter describes these attribution rules as being "cunningly devised with diabolical intent to trap shareholders in closely held corporations who might wander unwittingly into the web so intricately woven." W. PAINTER, *supra*, at 268.

111. I.R.C. § 897(c)(6)(C) (Supp. V 1981) (lowering 50% requirement in I.R.C. § 318(a)(2)(C), (3)(C) (1976) to 5%).

112. *See id.* § 897(c)(4)(A).

113. *See id.* § 897(c)(4)(B) (including trusts and estates).

114. *But see* Taran, *The Quasi-Domestic Corporation for Foreign Investment in U.S. Real Estate*, 8 INT'L TAX J. 16 (1981) (arguing that FIRPTA can be avoided through use of "quasi-domestic" corporations).

115. *See supra* notes 78-81 and accompanying text (explaining availability of annual election of trade or business status under some tax treaties).

sales price (and therefore, the bulk of his profit)[116] to be paid in subsequent years. If he was not engaged in a trade or business during those subsequent years, the gains received at that time would not be "effectively connected" income and therefore would be free of United States tax.[117] Now, however, an investor's "trade or business" status has no effect on the taxability of those gains.[118]

Other avoidance arrangements were not quite so easily dismantled. Consider, for instance, the ordinary "like kind" exchange under section 1031. Such exchanges allow tax-free trades of real estate without regard to whether the property is improved or unimproved, rural or urban, apartments or warehouses.[119] Because the taxpayer's basis in the old property is carried over to the new parcel,[120] the gain realized on the trade is merely deferred until this new property is sold. But if a foreign investor exchanges his United States land for land in some other country, he can achieve exemption, not merely deferral, of his gain.[121] This exemption results because the eventual disposition of the foreign property generally produces foreign source income[122] that is not "effectively connected" with a United States "trade or business."[123] In fact, because this gain derives from the sale of *non*-United States real estate, even FIRPTA's expansive "trade or business" rule does not curtail this arrangement.

For that reason, FIRPTA provides that "any nonrecognition provision shall apply . . . only in the case of an exchange of a United States real property interest for an interest the sale of which would be subject to taxation."[124] Thus, the exchange of United States land for foreign land is not eligible for "like kind" treatment because the sale of the latter would not be subject to United States tax. In the absence of "like kind" treatment, of course, gains are recognized to the extent that the value of the parcel exceeds the taxpayer's basis in his old parcel.[125] Accordingly, tax would now be imposed upon a United States-for-foreign real estate exchange.

The reach of this nonrecognition provision override is potentially enormous. In addition to "like kind" exchanges, this rule affects property transfers in corporate reorganizations,[126] partnership contributions and distributions,[127] and

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116. I.R.C. § 453(c) (Supp. V 1981) (pro rata recognition of profit as payments are received). *See generally* 4 B. BITTKER, *supra* note 37, at S106-1 to S106-9 (Supp. No. 1, 1983) (describing extensive amendments to § 453 by Installment Sales Revision Act of 1980); Ginsburg, *Future Payment Sales After the 1980 Revision Act*, 39 N.Y.U. INST. FED. TAX'N ch. 43 (1981) (same); Kurn & Nutter, *The Installment Sales Revision Act of 1980: In the Name of Simplification Has a Measure of Complexity Been Added?*, 8 J. REAL EST. TAX'N 195 (1981) (same).

117. Treas. Reg. § 1.864-3(a), (b) Ex.(1) (1972); TREASURY REPORT, *supra* note 3, at 30.

118. I.R.C. § 897(a)(1) (Supp. V 1981).

119. Treas. Reg. § 1.1031(a)-1(b) (1967). Any cash or other nonqualifying property, however, is treated as boot, and gain is recognized to that extent. I.R.C. § 1031(b) (1976). *See generally* 2 B. BITTKER, *supra* note 37, ¶ 44.2 (discussing "like kind" exchanges).

120. I.R.C. § 1031(d) (1976).

121. *See* TREASURY REPORT, *supra* note 3, at 31.

122. I.R.C. § 862(a)(5) (Supp. V 1981).

123. *See* I.R.C. § 864(c)(1)(A), (4)(A) (1976) (foreign source income not "effectively connected" even if there is a United States "trade or business"); *see also id.* § 864(c)(1)(B).

124. *Id.* § 897(e)(1) (Supp. V 1981).

125. *Id.* §§ 1001(a), (b), 1011(a), 1012 (1976).

126. *Id.* §§ 354(a)(1), 361(a), 897(e)(3) (1976 & Supp. V 1981).

127. *Id.* §§ 721(a), 731(a), 897(e)(3).

other transactions as well.[128] Congress recognized the unintended havoc this rule could wreak and directed the Treasury Department to issue regulations[129] indicating when the nonrecognition provisions continue to apply, notwithstanding FIRPTA's general prohibition. But artful dodgers can take little solace from this authorization. The statute states that the regulations are "to prevent the avoidance of Federal income taxes,"[130] and the Committee Report mandates that gain be recognized whenever property "would not be subject to tax on a later disposition of the property by the recipient."[131] In other words, the Treasury's regulations are to facilitate normal business transactions, but only when the ultimate taxability of gain is not in jeopardy.

With respect to corporate distributions of United States real property interests, FIRPTA takes a similar approach. The particular rules vary depending upon whether the company holding the real estate is a foreign[132] or a domestic[133] corporation, but the result is the same: gain on the underlying real estate no longer escapes United States taxation.[134] Moreover, Congress seems unusually determined that this result prevail. For example, when concern surfaced after FIRPTA's passage about the possible use of Virgin Islands corporations to circumvent its provisions, Congress promptly amended FIRPTA to eliminate this possibility[135] and made the amendments *retroactive* to June 18, 1980, FIRPTA's original effective date.[136] Thus, it seems fairly clear that gains on United States real estate dispositions are subject to tax without regard to the mechanics by which they are realized.[137]

IV. INTERNATIONAL COMITY AND THE TAX TREATY-FIRPTA INTERSECTION

As explained previously, the principal significance of tax treaties for pre-1980 real estate investments was the option to claim "trade or business" status

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128. *See, e.g., id.* § 351(a) (Supp. V 1981) (corporate organizations), *id.* § 897(e)(3) (broadly defining "nonrecognition provision") *see also id.* § 897(e)(1), (j) (recognition of gain on certain contributions to capital).

129. *Id.* § 897(e)(2). Those regulations were not included in the first set of rules promulgated. *See* 47 Fed. Reg. 41,532, 41,532-56 (1982).

130. I.R.C. § 897(e)(2) (Supp. V 1981).

131. H.R. REP. No. 215, 97th Cong., 1st Sess. 277 (1981).

132. *See* I.R.C. § 897(d)(1) (Supp. V 1981); *see also* Feder & Parker, *supra* note 89, at 564-66 (discussing generally corporate distributions by foreign corporations). Exclusionary regulations are also authorized in this context. *See* I.R.C. § 897(d)(1)(A) (Supp. V 1981).

133. *See* I.R.C. § 897(f) (Supp. V 1981).

134. *See also id.* § 897(d)(2) (foreign corporations with United States real property holdings may not liquidate tax-free under I.R.C. § 337). This amendment responds to a common pre-1980 practice whereby a foreign investor caused his holding company to sell its United States real estate and liquidate within 12 months, thereby avoiding any United States tax on the disposition. *See* TREASURY REPORT, *supra* note 3, at 30-31.

135. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831(a)(1), (2), 95 Stat. 172, 352 (adding I.R.C. § 862(a)(8) (Supp. V 1981) and amending *id.* § 897(c)(1)(A)(i)).

136. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831(i), 95 Stat. 172, 355; Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1125(a), 94 Stat. 2599, 2690. The Committee Report's "explanation" of the Virgin Islands amendment and the "mirror system" that necessitated it should be restricted to rated chessplayers and others bored by Rubik's Cube. H.R. REP. No. 215, 97th Cong., 1st Sess. 276-77 (1981).

137. *But see* Nihill, *supra* note 89, at 321-31 (describing possible lacunae). *See generally* Bittker, *Income Tax "Loopholes" and Political Rhetoric*, 71 MICH. L. REV. 1099, 1102-08 (1973) (unintended gaps in statutory drafting usually corrected swiftly).

on an annual basis.[138] This provision is now largely useless, however, because FIRPTA makes such status irrelevant in determining the taxability of real estate gains. Unfortunately, a new treaty problem arises regarding stock of companies that own United States real estate.

Before 1980 a foreign investor often realized his gain in a company's real estate holdings by selling the stock of that company rather than having the company sell its assets.[139] The company, in many cases, was engaged in a "trade or business" (of managing the property), while the investor was not so engaged, stock ownership itself not constituting a trade or business.[140] The investor's gain, therefore, was usually tax-free. Now, however, that gain is taxable, because FIRPTA treats the stock of companies that own real estate as "real property interests."[141] At the same time, many tax treaties exempt from United States taxation any capital gains realized by residents of the other signatory country.[142] Although these provisions typically exclude real estate gains from their protection,[143] they do apply to gains from the disposition of corporate stock, including, presumably, stock of real estate holding companies. Thus, there is a rather direct confrontation between the treaty capital gain exemptions and FIRPTA's treatment of real estate company stock.

A. THE OPTIONS AVAILABLE

In resolving this conflict, Congress had two choices. On one hand, it could provide that all existing treaties take precedence over FIRPTA. Doing so, however, would virtually emasculate the new statute, because most—if not all—foreign investors would then channel their United States investments through treaty country entities. Moreover, even if strong provisions denying treaty benefits to nonsignatory residents were imposed,[144] the statute's obeisance to existing treaties would create two distinct classes of foreign investors: those protected by these treaties, and everyone else. To be sure, such distinctions among foreign investors are inevitable in a less than comprehensive tax treaty network, but the significance of this particular distinction might make

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138. *See supra* notes 78-81 and accompanying text.

139. *See* TREASURY REPORT, *supra* note 3, at 31.

140. *See* Whipple v. Commissioner, 373 U.S. 193, 202 (1963) ("trade or business" status under I.R.C. § 165); Higgins v. Commissioner, 312 U.S. 212, 218 (1941) ("trade or business" status under I.R.C. § 162).

141. I.R.C. § 897(a)(1), (c)(1)(A)(ii) (Supp. V 1981); *see supra* notes 94-102 and accompanying text (discussing FIRPTA's treatment of disposition of real estate company stock).

142. *See, e.g.,* French Treaty, *supra* note 79, art. 12(1), 19 U.S.T. at 5298; German Treaty, *supra* note 79, art. IXA(1), 16 U.S.T. at 1882; Netherlands Treaty, *supra* note 79, art. XI(1), 17 U.S.T. at 902; Norwegian Treaty, *supra* note 77, art. 12(1), 23 U.S.T. at 2845; *see also* TREASURY REPORT, *supra* note 3, at 39-40 (tabular compilation showing all treaties with this exemption provision). In each treaty, this exemption is conditioned upon the foreign investor's not having a "permanent establishment" in the United States. *See* TREASURY REPORT, *supra* note 3, at 39-40. Most real estate investors operating without an office in this country should be able to satisfy this condition. *See* de Amodio v. Commissioner, 34 T.C. 894, 909 (1960) (agent's office not attributed to principal as "permanent establishment"), *aff'd on other grounds*, 299 F.2d 623 (3d Cir. 1962). *See supra* note 77 (discussing "permanent establishment" concept).

143. TREASURY REPORT, *supra* note 3, at 39-40; *see, e.g.,* German Treaty, *supra* note 79, arts. IX(1), IXA(1), 16 U.S.T. at 1882-83; Netherlands Treaty, *supra* note 79, art. XI, 17 U.S.T. at 902; Norwegian Treaty, *supra* note 77, art. 12(1)(a), 23 U.S.T. at 2845.

144. *See supra* notes 83-87 and accompanying text (discussing use of tax treaties by third-country investors).

the resulting situation politically intolerable. Claims of unfair treatment would surely be voiced, particularly by private foreign investors without access to treaty country investment vehicles.

On the other hand, Congress could simply override these treaties, either explicitly or by enacting a clearly inconsistent statute,[145] such as FIRPTA. That would certainly keep FIRPTA viable and would treat all foreign investors alike, but at what cost? The idea of a bilateral tax treaty, after all, is that two countries came together and negotiated a package of incentives and concessions that was mutually acceptable.[146] There are always some provisions that one country finds less attractive than other provisions, but if the *package* of provisions is acceptable when considered as a whole, a treaty is signed and should be respected. The implied understanding is that both parties will honor all of the provisions until such time as they negotiate a new treaty, and then of course the whole treaty is up for grabs, not just a few particularly distasteful provisions.

There is, to be sure, a provision for unilateral renunciation in all tax treaties[147] and this option is occasionally exercised. For example, the United States renounced its treaty with the British Virgin Islands on June 30, 1982, after that country had refused the United States' request for an anti- "treaty shopping" provision.[148] But this renunciation came only after extensive negotiations had failed to produce a compromise. Moreover, the renunciation applied to the *entire* treaty, including those provisions favored by the United States.

Contrast that situation with the unilateral renunciation of an isolated provision. Such a renunciation upsets the parties' bargain and therefore strikes at

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145. *See* Reid v. Covert, 354 U.S. 1, 18 (1957) (subsequent acts of Congress override conflicting prior treaty provisions); The Chinese Exclusion Case, 130 U.S. 581, 602-03 (1889) (same); Whitney v. Robertson, 124 U.S. 190, 194 (1888) (same); Rev. Rul. 81-303, 1981-2 C.B. 255 (providing example); Rev. Rul. 80-201, 1980-2 C.B. 221 (same); Rev. Rul. 80-223, 1980-2 C.B. 217 (same); L. HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 163-64 (1972) (subsequent acts of Congress override conflicting prior treaty provisions); RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 145 (1965) (subsequent acts of Congress supersede an inconsistent treaty if the intent of Congress to override the treaty is clearly expressed). *See generally* Brecher, *Relationship of, and Conflicts Between Income Tax Treaties and the Internal Revenue Code*, 24 TAX EXECUTIVE 175 (1972) (discussing problems that can arise when tax treaties conflict with Code).

146. *See generally* STAFFS OF THE JOINT COMM. ON TAXATION AND THE SENATE COMM. ON FOREIGN RELATIONS, 96TH CONG., 1ST SESS., TAX TREATIES: STEPS IN THE NEGOTIATION AND RATIFICATION OF TAX TREATIES AND STATUS OF PROPOSED TAX TREATIES 1-2 (Joint Comm. Print 1979) (discussing steps in negotiating tax treaties); Klock, *The Role of United States Income Tax Treaties; Two Spheres of Negotiations*, 13 TEX. INT'L L.J. 387 (1978) (role of United States income tax treaties is to serve interests of two countries involved rather than to relieve citizens of double taxation); Smith, *The Functions of Tax Treaties*, 12 NAT'L TAX J. 317 (1959) (discussing tax treaties as vehicles for relief of double taxation); Surrey, *Factors Affecting U.S. Treasury in Conducting International Tax Treaties*, 28 J. TAX'N 277 (1968) (discussing factors that the Treasury considers in treaty negotiations with developed and less developed countries); Surrey, *International Tax Conventions: How They Operate and What They Accomplish*, 23 J. TAX'N 364 (1965) (discussing briefly purposes and negotiation of tax treaties).

147. *See, e.g.*, Netherlands Treaty, *supra* note 79, art. XXVIII(2), 62 Stat. at 1765. This provision is effective after a treaty has been in force for five years and requires six months advance notice. *Id.*; U.S. DEP'T OF THE TREASURY, MODEL CONVENTION ON INCOME TAXES art. 29(1) (1981), *reprinted in* 1 TAX TREATIES (CCH) ¶ 158, at 266 (1981), *and* 3 R. RHOADES & M. LANGER, *supra* note 72, § 15.09, at 15-420.

148. DAILY TAX REP. (BNA), July 1, 1982, at G-1 (Daily Report for Executives). For an analysis of the developments affecting this treaty, see Note, *Renegotiation of the United States-British Virgin Islands Tax Convention: Prelude to the End of Treaty Shopping?* 22 VA. J. INT'L L. 381 (1982).

the very heart of the treaty process. A nation may always cast aside an entire treaty, declining its benefits as well as its burdens, but renouncing specific provisions changes a deal after it is made. Moreover, if the United States can renounce specific treaty provisions it no longer wants, whenever it no longer wants them, what is to stop other countries from doing likewise? And if that is the situation, why have a treaty at all? Such a treaty obviously binds neither party, although that is precisely what treaties are supposed to do.

B. THE SOLUTION ADOPTED

Congress clearly was caught between Scylla and Charybdis. Honoring the treaties would make FIRPTA a paper tiger. Overriding the treaties would violate the fundamental premises undergirding such agreements. In desperation, Congress tried to forge a course midway between these two extremes: honor the treaty exemptions until 1985, but after that date FIRPTA takes precedence.[149] And if a treaty is renegotiated before 1985, the old treaty's exemption stays in effect for up to two years after the new treaty is signed.[150] Thus, a series of effective dates exists: June 18, 1980 for investors without treaty protections; January 1, 1985 for investors with treaties that are not renegotiated before then; and dates possibly as late as December 31, 1986 for investors with treaties that are not so renegotiated.[151]

This bizarre attempt at Solomonic justice actually had the blessing of the agency charged with negotiating those tax treaties, the Treasury Department:

> The process of negotiating and ratifying a tax treaty . . . would be rendered all the more difficult, if not altogether impossible, if the United States were to begin overriding specific treaty provisions that a foreign country had negotiated in good faith. . . . Accordingly, we are opposed to any statutory changes which would immediately override our tax treaty obligations, but are willing to contemplate provisions which would allow the Treasury sufficient time to implement appropriate modifications in those treaties before statutory changes become effective.[152]

The result is a crazy quilt system of effective dates that encourages renegotiation but also rewards those who do not renegotiate too early. Furthermore, practitioners cannot give a straightforward answer to a question as simple as "when does FIRPTA take effect?" Instead, investors face a sort of Russian roulette in which their real estate transactions may or may not be taxable, depending upon when their nation's new tax treaty, if any, is signed.

Of course, the investors who are especially aggrieved by this solution are those who, for whatever reason, did not initially structure their investments to

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149. Foreign Investment In Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1125(c)(1), 94 Stat. 2599, 2690 (not codified).

150. *Id.* § 1125(c)(2), 94 Stat. at 2690, *amended by* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831(h), 95 Stat. 172, 355 (not codified).

151. *See* H.R. REP. No. 215, 97th Cong., 1st Sess. 278 (1981).

152. *Taxation of Foreign Investor Direct and Indirect Ownership of Property in the United States: Hearing Before the House Comm. on Ways and Means*, 96th Cong., 1st Sess. 7 (1980) (statement of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy).

obtain a treaty exemption. These poor souls are stuck with the June 18, 1980 effective date that was inserted into FIRPTA upon its enactment in December 1980, too late to do any rehabilitative planning.[153] Needless to say, many of these investors would like to rearrange their investments into a treaty country vehicle before disposition to obtain the benefits they did not originally secure. This plan, however, is thwarted by FIRPTA's curtailment of the nonrecognition provisions that make corporate realignments tax-free.[154] Indeed, Congress made its intent on this point absolutely clear:

> Congress provided a grace period of tax exemption until January 1, 1985 to certain foreign investors who were residents of a treaty country . . . . *However, it was not Congress' intent to grant such an exemption to a foreign investor, who after the enactment of [FIRPTA] rearranged his investment so as to come under a treaty* which would exempt the gain from U.S. tax . . . .[155]

Thus, discrimination against nontreaty-country investors vis-à-vis treaty-country investors is a clearly intended consequence of FIRPTA's effective date regime.

But what purpose is served by such discrimination? Has the cause of international comity really been advanced by the delayed treaty override? Is the arrogance of single provision renunciation somehow mitigated by the renegotiation incentive Congress created? After all, FIRPTA presents the treaty negotiators with a fait accompli. If the treaty is not renegotiated before 1985, the treaty's capital gains exemption is overridden without further ado. The negotiators cannot change that result without destroying FIRPTA entirely. Only the date on which the override takes effect is negotiable, and even that variable is closely circumscribed by the new statute. The delayed treaty override, in other words, is neither fish nor foul and manages to alienate all parties concerned while posing as a reasonable compromise.

To be sure, the treaty-FIRPTA conflict does not seem to have a truly satisfactory solution. In fact, this problem may be endemic to the treaty process itself and will arise whenever one signatory country makes a policy shift that conflicts with existing tax treaties. Nevertheless, it is clear that the solution Congress adopted to ensure FIRPTA's effectiveness has significant costs in terms of diplomatic capital and possible future repercussions. Whether the benefits of FIRPTA can ever exceed these very real costs is the question one must ponder.

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153. The retroactive effective date does not affect the statute's validity. *See* 1 B. BITTKER, *supra* note 37, ¶ 1.2.6. *See generally* Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revisions*, 126 U. PA. L. REV. 47 (1977) (discussing equity of retroactive income tax provisions); Williams, *Retroactivity in the Federal Tax Field*, 12 S. CAL. TAX INST. 79 (1960).

154. *See* I.R.C. § 354(a)(1) (1976 & Supp. V 1981) (nonrecognition provision for shareholders in reorganizations), *id.* § 361(a) (1976) (nonrecognition provision for corporations in reorganizations), *id.* § 897(e)(1) (curtailment of nonrecognition provisions). *See supra* notes 124-31 and accompanying text (discussing FIRPTA's override of nonrecognition provisions).

155. H.R. REP. NO. 215, 97th Cong., 1st Sess. 280-81 (1981) (emphasis added). For a further example of congressional intent to minimize avoidance possibilities, see *id.* at 278.

V. THE PROBLEM OF ENFORCEABILITY

Inherent in any tax statute is the problem of its enforceability. Can the government really collect the levy it purports to impose? This problem is particularly acute in the case of FIRPTA because the class of persons affected by this statute is effectively exempt from customary enforcement sanctions. For example, an individual who does not reside in the United States is less susceptible to being arrested and, accordingly, is less concerned about the Code's imprisonment provisions[156] than a resident would be. Similarly, someone who does not engage in a trade or business in this country is likely to have fewer assets subject to the Code's property seizure provisions[157] than a person who is so engaged. Hence, the enforceability of FIRPTA is fraught with serious problems because the taxpayers affected are neither residents nor persons engaged in United States trades or businesses.

In point of fact, these very problems are the raison d'etre of the "loophole" that FIRPTA now closes. Congress exempted the capital gains of nonresident, nonbusiness foreign investors in 1936,[158] explaining its action as follows:

> Such a nonresident alien will not be subject to the tax on capital gains . . . as at present, *it having been found administratively impossible effectually to collect this latter tax*. It is believed this exemption from tax will result in considerable additional revenue . . . from the income tax in the case of persons carrying on the brokerage business.[159]

Thus, the exemption of United States source capital gains from tax was not some legislative oversight. Rather, it represented a deliberate recognition of the limitations of enforceability, coupled with a hope that the revenue forgone by its creation would be offset by taxes on the increased earnings of stockbrokers and other middlemen. However optimistic this early manifestation of "supply side" ideology[160] may have been, it seems clear that enforceability is a major problem in this context. Among the responses available to Congress are information reporting requirements and withholding of sales proceeds, both of which are considered in this section.

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156. *See* I.R.C. §§ 7201-7216 (P-H 1982). *See generally* 4 B. BITTKER, *supra* note 37, ¶ 114.4 (discussing criminal fraud and other tax crimes); 1 R. FINK, TAX FRAUD—AUDITS, INVESTIGATIONS, PROSECUTIONS ch. 16 (1981) (discussing criminal charges).

157. *See* I.R.C. §§ 6331-6343 (P-H 1982); *see also id.* §§ 6321-6325 (liens). *See generally* 4 B. BITTKER, *supra* note 37, ¶ 111.5.4-.6 (discussing seizure of property and lien provisions); M. SALTZMAN, IRS PRACTICE AND PROCEDURE ch. 14 (1981) (discussing tax collection measures including liens and levies). On the difficulties of securing enforcement of United States tax claims against assets located outside the United States, see Note, *The Nonrecognition of Foreign Tax Judgments: International Fiscal Evasion*, 1981 U. ILL. L. REV. 241.

158. *See* Revenue Act of 1936, Pub. L. No. 740, § 211(a), 49 Stat. 1648, 1714.

159. S. REP. No. 2156, 74th Cong., 2d Sess. 21 (1936), *reprinted in* 1939-1 (Part 2) C.B. 678, 692 (emphasis added); *see also* H. R. REP. No. 2475, 74th Cong., 2d Sess. 9 (1936), *reprinted in* 1939-1 (Part 2) C.B. 667, 673 (containing similar language); *cf.* Commissioner v. Nubar, 185 F.2d 584, 586 (4th Cir. 1950) (dictum) (statute exempts only those "aliens over whom no effective jurisdiction in enforcement of the tax laws could be exercised"), *cert. denied*, 341 U.S. 925 (1951).

160. *See generally* B. BARTLETT, REAGANOMICS (1981); J. KEMP, AN AMERICAN RENAISSANCE: A STRATEGY FOR THE 1980S (1979); J. WANNISKI, AN AUTHORITATIVE GUIDE TO SUPPLY-SIDE ECONOMICS (1980).

A. REPORTS OF REAL ESTATE HOLDINGS

Under FIRPTA foreign investors who own "real property interests"[161] with a market value of at least $50,000 must file reports listing their names and addresses, as well as "a description of all United States real property interests" that they hold.[162] Similarly, any corporation that is a "United States real property holding corporation"[163] during the year or during the previous four years must report the names and addresses of its foreign shareholders and any transactions in its stock involving those shareholders.[164] A comparable reporting obligation is imposed on partnerships, trusts, and estates in which a foreign person holds a pro rata interest in the entity's real estate holdings that is worth at least $50,000.[165] The usual network of attribution rules is incorporated,[166] but most of the details are left to regulations specifically authorized by the new statute.[167] In all, a rather comprehensive set of information returns is envisioned by FIRPTA.

The objective of these various reports, presumably, is to determine whether foreign investors have faithfully reported all taxable sales and exchanges. But one must seriously question the efficacy of information returns in this context. For one thing, these reports are required annually,[168] even though there may

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161. *See* I.R.C. §§ 897(c)(1)(A), 6039C(d)(1) (Supp. V. 1981); *See also supra* notes 91-102 and accompanying text (discussing broad meaning of statutory term, "United States real property interest").

162. I.R.C. § 6039C(c)(1)(A), (B), (2)(B) (Supp. V 1981) (added by Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1123(a), 94 Stat. 2599, 2687). This requirement applies only if the foreign person is not engaged in a United States trade or business during the year in question. *Id.* § 6039C(c)(2)(A). Additional information may be required by regulations. *Id.* § 6039C(c)(1)(C); *see* Temp. Treas. Reg. § 6a.6039C-4 (1982). *See generally* Richards, *Telling the Taxman: Reporting and Avoidance under FIRPTA*, 17 REAL PROP. PROB. & TRUST J. 1 (1982) (analyzing FIRPTA's reporting provisions).

163. *See* I.R.C. §§ 897(c)(2), 6039C(a)(1)(B)(ii) (Supp. V 1981); *see also supra* notes 100-02 and accompanying text (discussing meaning of statutory term, "United States real property holding corporation").

164. I.R.C. § 6039C(a)(1)(A)(i), (ii), (B) (Supp. V 1981). *See also id.* § 6039C(a)(3) (report required of any nominee holding stock "for a foreign person" if that foreign person fails to provide required information himself). These provisions do not apply to corporations whose stock "is regularly traded on an established securities market at all times" during the year. *Id.* § 6039C(a)(2).

165. *Id.* § 6039C(b)(1), (3), (4)(A), (B)(i); *see* Temp. Treas. Reg. § 6a.6039C-3(b) (1982). No report is required, however, if the entity "furnishes to the Secretary such security as the Secretary determines to be necessary to ensure that any tax imposed by [I.R.C. § 897] with respect to United States real property interests held by such entity will be paid." I.R.C. § 6039C(b)(2) (Supp. V 1981). Congress explained:

> It is expected that the security which the IRS would consider to be satisfactory for this purpose would depend upon the circumstances. Thus, for example, in the case of a foreign corporation the only asset of which is a tract of undeveloped U.S. real estate, the IRS might require a recorded security interest in the real estate, a guarantee by a person from whom the IRS would be reasonably certain it could collect the unpaid tax, or some similar type of security.

H.R. REP. No. 1479, 96th Cong., 2d Sess. 191 (1980). Apparently this exception is intended to enable entities that would prefer not to identify their beneficial owners to avoid doing so without jeopardizing the ultimate collection of tax upon disposition. *Id.* at 190-92. *See also* Temp. Treas. Reg. § 6a.6039C-5 (1982) (describing procedures for furnishing security and determining the type and amount required).

166. *See* I.R.C. § 6039C(b)(4)(B)(ii), (C), (e)(1) (Supp. V 1981).

167. *See id.* § 6039C(a)(1)(A)(ii), (iii), (b)(1)(B), (C), (3)(C), (c)(1)(C), (e)(2) (specific grants of regulatory authority). The reports required by these statutory provisions are to be made on Internal Revenue Service Forms 6659, 6660, and 6661, which are described in Temp. Treas. Reg. §§ 6a.6039C-2, 6a.6039C-3, and 6a.6039C-4 (1982), respectively.

168. *See* I.R.C. § 6039C(a)(1)(A), (b)(1), (c)(1) (Supp. V 1981). These reports are due on May 15 for the preceding calendar year, except that the reports for 1980 through 1982 are due on a date to be

have been no changes since the last report. Yet, only *dispositions* of real estate trigger imposition of tax.[169] Does the Service really intend to compare every investor's annual reports in search of a disposition that was not included on his tax return? This process would surely resemble the proverbial search for a needle-in-a-haystack and could not possibly be an efficient use of limited enforcement resources. Moreover, the basic data in these reports are property descriptions,[170] not dollar amounts,[171] and accordingly, the process of making these year-to-year comparisons cannot be easily computerized.[172] Hence, the effective utilization of these reports seems dubious at best.

This analysis assumes, of course, that the reports will in fact be filed. Given the preference of many foreign investors for anonymity,[173] that assumption may be a bit tenuous. To be sure, no attorney[174] or accountant[175] may ethically counsel noncompliance, but unethical advisers do exist, and in many instances the foreign investor may be acting without professional advice at all. The statute does impose a $25-per-day penalty for failure to file required reports,[176] but even this paltry sum is limited to a maximum of $25,000[177] or, in some cases, 5% of a property's "fair market value," if lower.[178] The usefulness, therefore, of FIRPTA's information reporting system—which is already somewhat questionable—is undercut still further by the rather insubstantial penalties provided for nonreporting foreign investors.[179]

Moreover, even these penalties can be imposed only if a nonreporting foreign investor is actually discovered. But how can the Internal Revenue Service ferret out such persons? Does it plan on scouring the nation's deed recordation offices on a regular basis, in effect creating some sort of nationwide Torrens system? The very suggestion seems preposterous, but in fact there may be few

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established by the finalized regulations. Treas. Reg. § 6a.6039C-1(c) (1982), *as amended*, 48 Fed. Reg. 19, 163 (1983).

169. I.R.C. § 897(a)(1) (Supp. V 1981).

170. *See id.* § 6039C(b)(1)(B), (c)(1)(B). *But see id.* § 6039C(a)(1)(A)(ii) (requiring information about *transfers* of stock).

171. *Cf. id.* § 6042(a)(1) (amount of dividends, if more than $10, must be reported), *id.* § 6043(a)(2) (amounts distributed in corporate liquidations), *id.* § 6049(a)(1) (amount of interest payments, if more than $10) (P-H 1982).

172. This problem of "information overload" is compounded by the requirement of duplicative reports by certain corporations and their shareholders. *See* I.R.C. § 6039C(a)(1)(A)(i), (c)(1)(B) (Supp. V 1981).

173. *See* M. LANGER, PRACTICAL INTERNATIONAL TAX PLANNING 65, 83-84 (2d ed. 1979) (discussing business advantages of anonymity); Guenther, *Many Foreign Investors Chafe at Law Curtailing Anonymity*, Wall St. J., Apr. 27, 1983, at 31, col. 1 (describing foreign investor's hostility to FIRPTA's disclosure requirements).

174. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(7) (attorney may not counsel or assist client in illegal or fraudulent conduct). *See generally* B. WOLFMAN & J. HOLDEN, ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE ch. 2 (1981) (discussing ethical problems of return preparation).

175. *See* AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, STATEMENTS ON RESPONSIBILITIES IN TAX PRACTICE No. 6 ¶ .04A (1970) (CPA required to advise compliance); *see also* Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries before the Internal Revenue Service, 31 C.F.R. § 10.22(a) (1982) (requiring "due diligence" in determining correctness of information filed).

176. I.R.C. § 6652(g)(2) (Supp. V 1981).

177. *Id.* § 6652(g)(3)(A).

178. *Id.* §§ 6039C(c), 6652(g)(3)(B). Criminal sanctions may also apply. *See id.* § 7203 (P-H 1982).

179. On the interaction of penalties and taxpayer compliance generally, see Hoeflich, *Of Reason, Gamesmanship, and Taxes: A Jurisprudential and Games Theoretical Approach to the Problem of Voluntary Compliance*, 2 AM. J. TAX POL'Y (forthcoming).

alternatives available. The reports required of foreign investors by the International Investment Survey Act[180] are confidential and not available to tax collectors.[181] Reports required by the Agricultural Foreign Investment Disclosure Act,[182] on the other hand, are open to the public[183] but are limited to farmland and do not include urban real estate holdings.[184] In any case, the use of one unwieldy mass of data to cross-check another such mass, each created under different statutory parameters, seems likely to generate more confusion than assistance. Information reporting alone, quite obviously, cannot ensure FIRPTA's enforceability.

B. WITHHOLDING SALES PROCEEDS

To ensure collection of taxes owed by nonresidents who are not engaged in United States business activities, the Code has long relied on withholding these taxes from the investor's income.[185] Taxes on interest income, dividends, rents, and other "fixed or determinable annual or periodical income"[186] are simply withheld by the person making such payments and remitted to the government on the foreign investor's behalf. Should the person making these payments fail to withhold the required amounts, that person is subject to assessment, plus penalties, for the amounts not so withheld.[187]

Such a withholding system was part of FIRPTA's original conception[188] and was included in the Senate's version of that enactment.[189] The House of Representatives, however, objected to this idea and deleted it from the final bill.[190]

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180. 22 U.S.C. §§ 3101-3108 (1976 & Supp. V 1981). *See supra* notes 10-15 and accompanying text (discussing the Act's reporting requirements).

181. *See* 15 C.F.R. § 806.5 (1982) (information available only to administrators of program); *see also* H.R. REP. NO. 1490, 94th Cong., 2d Sess. 3 (1976), *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 4663, 4665 (same).

182. 7 U.S.C. §§ 3501-3508 (Supp. V 1981). *See supra* notes 17-19 and accompanying text (discussing the Act's reporting requirements).

183. 7 U.S.C. § 3506.

184. *See id.* §§ 3501, 3508.

185. *See* I.R.C. § 1441 (nonresident aliens), *id.* § 1442 (foreign corporations). *See generally* 3 B. BITTKER, *supra* note 37, ¶ 66.6 (discussing withholding of tax at source); 1 R. RHOADES & M. LANGER, *supra* note 72, § 2.24 (same); S. ROBERTS & W. WARREN, UNITED STATES INCOME TAXATION OF FOREIGN CORPORATIONS AND NONRESIDENT ALIENS ch. VIII (1966 & Supp. 1967) (same); Dale, *Withholding Tax on Payments to Foreign Persons*, 36 TAX L. REV. 49 (1980) (same). The rate of tax withheld is 30% of gross receipts unless otherwise specified by the Code, I.R.C. §§ 1441, 1442 (1976), or an applicable treaty. *See id.* § 7852(d); *see also* INTERNAL REVENUE SERVICE, WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS 16-17 (Pub. No. 515, 1980), *reprinted in* 2 R. RHOADES & M. LANGER, *supra* note 72, at A-16 to A-17 (tabular listing of withholding rates for each type of income by treaty country).

186. *See* I.R.C. §§ 871(a)(1)(A), 881(a)(1) (1976).

187. *Id.* §§ 1461, 6672(a), 7202, 7501(a) (1976 & Supp. V 1981). *See generally* 4 B. BITTKER, *supra* note 37, ¶ 114.3.5 (discussing consequences of failure to withhold and collect third-party taxes); Dale, *supra* note 185, at 77-84, (discussing liability of "underwithholding agent").

188. *See* S. 208, 96th Cong., 1st Sess. § 1(b), 125 CONG. REC. 929 (1979) (capital gains of nonresident aliens and foreign corporations from sale of United States agricultural land would be subject to the Code's withholding provisions); *see also* H.R. 3106, 96th Cong., 1st Sess., 125 CONG. REC. 5598 (1979) (similar legislation in House).

189. *See* S. 2939, 96th Cong., 2d Sess. § 203(a), 126 CONG. REC. S9312 (daily ed. July 2, 1980) (capital gains of nonresident aliens and foreign corporations from sale of all United States real property interests would be subject to Code's withholding provisions); *see also* S. REP. NO. 504, 96th Cong., 1st Sess. 9-11 (1979) (purchaser required to withhold tax); Richards, *The Foreign Seller of U.S. Real Estate: Withholding Requirements*, 6 INT'L TAX J. 292 (1980) (discussing proposed legislation).

190. H.R. REP. NO. 1479, 96th Cong. 2d Sess. 189-90 (1980).

In explaining this action, the Conference Committee stated:

> [I]t would be necessary to structure withholding provisions carefully to ensure that they would not inadvertently disrupt the U.S. real estate market or expose U.S. buyers or U.S. agents of foreign sellers of U.S. real estate to liability where such liability would not be appropriate. Given this potential, the . . . withholding provisions should not be adopted until they could be more fully considered . . . and the public had adequate opportunity to consider and comment on the proposed withholding mechanism.[191]

Despite this request for more deliberate consideration, the Senate included a very similar withholding scheme in its version of the Economic Recovery Tax Act of 1981.[192] Once again, however, the House conferees objected, and the provisions were removed from the final bill, this time without any explanatory comment.[193] The Senate continued its campaign and included a withholding mechanism in its version of the Tax Equity and Fiscal Responsibility Bill of 1982.[194] But as before, the House conferees insisted upon its removal.[195] Thus, FIRPTA has no withholding mechanism and seems unlikely to get one anytime soon.

The House's hesitancy to enact a withholding mechanism could be attributed to several problems inherent in that approach, not the least of which being when such withholding should apply. FIRPTA does not affect gains realized by aliens who are United States "residents" or by foreign investors who are engaged in a United States "trade or business," because those gains are already taxable by the United States.[196] Only gains realized by nonresident, nonbusiness investors are subject to FIRPTA's amendments.[197] In other words, any withholding mechanism for FIRPTA gains would require the withholding agent—potentially, any buyer of United States real estate—to determine not only whether the "real" seller is a foreign investor, but also whether that foreign investor is a nonresident not engaged in a United States trade or business. This latter determination is often quite difficult even when all the relevant facts are known.[198] To obligate every purchaser of United States real estate to make this determination would be unreasonably burdensome and potentially very disruptive.

On the other hand, this obligation is already imposed on payors of periodic payments, such as interest and dividends, that are subject to withholding requirements at the present time.[199] These requirements also apply only if a foreign recipient does not engage in a United States trade or business,[200] and a system of statements and certifications has been instituted to limit the with-

191. *Id.*
192. H.R.J. Res. 266, 97th Cong., 1st Sess. § 831, 127 CONG. REC. S8472-74 (daily ed. July 27, 1981).
193. *See* H.R. REP. No. 215, 97th Cong., 1st Sess. 280 (1981).
194. H.R. 4961, 97th Cong., 2d Sess. § 371(a), 128 CONG. REC. S8639-41 (daily ed. July 19, 1982).
195. *See* H.R. REP. No. 760, 97th Cong., 2d. Sess. 588 (1982).
196. *See supra* notes 32-87 and accompanying text.
197. *See supra* notes 88-137 and accompanying text.
198. *See supra* notes 45-57 and accompanying text (discussing real estate ownership as a "business").
199. *See* I.R.C. § 1441 (1976) (nonresident aliens), *id.* § 1442 (foreign corporations); *supra* note 185.
200. I.R.C. §§ 1441(c), 1442(a) (1976).

holding agent's exposure on this question.[201] Even so, the system is far from perfect, and persons making such payments tend to overwithhold to limit their potential liability.[202] In any case, the payors affected by the existing withholding system are, by and large, sophisticated financial institutions, while FIRPTA-related withholding requirements could conceivably affect every real estate buyer in the United States.

More fundamentally, the analogy to interest and dividend withholding is not appropriate for several structural reasons. First, in the case of interest, dividends, or similar receipts, the entire amount of the payment constitutes gross income.[203] In real estate sales, however, only the *gain* is taxable; that is, only the difference between the sales proceeds and the property's basis represents taxable receipts.[204] Moreover, the relevant basis figure is the *seller's* basis, which the buyer—who would have the withholding responsibility—has no easy way of determining. The seller could simply inform the buyer of his basis, of course, but such information is extremely sensitive. If the buyer learns the exact size of the seller's gain, the buyer might feel cheated and may want to renegotiate the sales price. This reaction is particularly likely when, as in the case of FIRPTA, the seller reaping the profit is a foreign investor. On the other hand, if the foreign seller overstates his basis to minimize this reaction, his gain is understated and the tax withheld will be inadequate. Although the law could require that a fixed percentage of the gross sales price be withheld,[205] that approach would almost always be wrong, overwithholding in some cases and underwithholding in others. The simple fact remains that the sales price is not taxable income; only the gain realized, *if any*, is taxable.

Further, even a withholding mechanism based on sales prices would be difficult to implement. Unlike interest and dividend payments, which are usually made in cash, real estate transactions are typically consummated with very little cash actually changing hands. Mortgages, newly created or simply assumed; agreements to pay certain expenses when due; promissory notes, secured by land or unsecured; and other noncash media are common components of real estate sales. How does one withhold ten percent, for example, from an assumed mortage? On promissory notes, does one withhold part of the note's discounted value, or does one wait until the payments are actually made? If the latter, what if the foreign investor's status as a nonresident or as not-engaged-in-business changes by then? In short, withholding sales proceeds in a real estate context is often impractical.

To be sure, each of these problems is solvable, at least to some degree. Certifications could be formulated to let real estate buyers know with whom they

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201. *See* Treas. Reg. §§ 1.1441-4(a)(2), (b)(2), (d)(2), (f)(2)(i) (1981), 1.1441-5(a) (1973), 1.1441-6(c) (1971) (requiring recipient to file statement of exemption from withholding with withholding agent).

202. *See* Dale, *supra* note 185, at 76-84.

203. I.R.C. §§ 871(a)(1)(A), 881(a)(1) (1976).

204. *Id.* §§ 1001(a), (b), 1011(a).

205. *See* Note, *Withholding from Recipients of FIRPTA Gain*, 35 VAND. L. REV. 439, 467-68 (1982) (proposing such an approach); *see also* H.R. 4961, 97th Cong., 2d Sess. § 371(a)(1), 128 CONG REC. S8639-41 (daily ed. July 19, 1982) (not enacted) (incorporating such an approach) [hereinafter 1982 Proposal]. *But see* Angell, *The Nonresident Alien: A Problem in Federal Taxation of Income*, 36 COLUM. L. REV. 908, 911-12 (1936) (arguing that "[i]t would be futile for Congress to undertake to exact a contribution out of the sales price").

are dealing.[206] De minimis exemptions could be created to reduce the paperwork and liability problems on smaller transactions.[207] Withholding on gross sales proceeds could be set at a sufficiently low rate to reduce overwithholding and could be made applicable only to cash proceeds controlled by the buyer.[208] But each of these proposals severely limits the withholding mechanism's ability to ensure the ultimate collection of the tax owed, which is, after all, the whole purpose of the mechanism. Yet, the absence of any withholding mechanism places the entire burden of enforcing FIRPTA on the reporting requirements discussed previously,[209] which clearly are not up to the task. Thus, there are significant chinks in FIRPTA's armor with respect to enforceability,[210] raising the question whether this new statute ought to exist at all.

VI. POLICY CONSIDERATIONS

As analyzed thus far, FIRPTA seems to be an almost perverse enactment. To repeal a relatively limited exemption of some forty-four years standing, Congress expended inordinate legislative effort in five separate sessions.[211] The resulting statute is complex, difficult to enforce, and disrespectful of existing tax treaty obligations.

Yet, FIRPTA was not some quirk of the legislative mill or the irrational obsession of some obscure Congressperson. Very much to the contrary, this legislation had no fewer than 49 *sponsors* in the Senate[212] and 151 sponsors in the House of Representatives.[213] FIRPTA, in other words, was one of the most popular pieces of tax legislation considered in recent years. It obviously responded to some rather widely-held views about appropriate tax policy, and it is those views that this section now examines. The section first addresses the question of unequal tax treatment for domestic and foreign investors that FIRPTA purports to correct. It then analyzes the effect FIRPTA will have on foreign investment in United States real estate. Finally, it considers whether such investment ought to be a matter of legislative concern at all.

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206. *See* 1982 Proposal, *supra* note 205 (proposing addition of I.R.C. § 1444(c), which would require foreign seller to furnish notice to his buyer); *supra* note 201 (same).

207. *See* 1982 Proposal, *supra* note 205 (proposing addition of I.R.C. § 1444(d)(3), which would exempt principal residences that cost no more than $200,000).

208. *See* 1982 Proposal, *supra* note 205 (proposing addition of I.R.C. § 1444(a)(2), which would require withholding 20% of amount realized or consideration that is within buyer's control, whichever is less). *But see id.* (proposing addition of I.R.C. § 1444(h)(4), which would include as consideration fair market value of property and face amount of any indebtedness that was created within two years of sale).

209. *See* I.R.C. § 6039C (Supp. V 1981); *supra* notes 161-84 and accompanying text.

210. *But see* Feder & Parker, *The Foreign Investment in Real Property Tax Act of 1980*, 34 TAX LAW. 545, 578-79 (1981) (suggesting that foreign investors will comply voluntarily if they expect ever to invest in United States again).

211. *See* S. 3414, 95th Cong., 2d Sess., 124 CONG. REC. 34,604 (1978) (reprinted as amendment 3988 to H.R. 13,511); S. 192, 96th Cong., 1st Sess., 125 CONG. REC. 795, 796 (1979); Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, §§ 1121-1125, 94 Stat. 2599, 2682; Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831, 95 Stat. 172, 352; H.R. 4961, 97th Cong., 2d Sess. § 371(a) (1982).

212. *See* S. 3414, 95th Cong., 2d Sess., 124 CONG. REC. 34,604 (1978) (reprinted as amendment 3988 to H.R. 13,511).

213. *See* H.R. 3106, 96th Cong., 1st Sess., 125 CONG. REC. 5598 (1979).

A. TAXING DOMESTIC AND FOREIGN INVESTORS

If an American citizen, or an alien who resides in the United States, or a nonresident alien who engages in a United States trade or business, invests in United States land, his gain upon disposition of that land is usually taxable.[214] Oftentimes, this gain will qualify for favorable treatment as a capital gain,[215] but it is taxable nevertheless. In contrast, certain foreign investors who do not engage in a United States "trade or business"[216] are exempt from tax on their United States source capital gains, including gains derived from sales of United States real estate. That, in a nutshell, is the dichotomy FIRPTA abolishes. Under FIRPTA, real estate profits are now taxable, no matter how limited a foreign investor's United States contacts may be.[217]

In fact, eliminating this dichotomy was the principal reason put forward for FIRPTA's enactment. As the Committee Report explained:

> The committee believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic investors. *The committee does not intend* by the provisions of this bill to impose a penalty on foreign investors or *to discourage foreign investors from investing in the United States*. However, the committee believes that the United States should not continue to provide an inducement through the tax laws for foreign investment in U.S. real property . . . [by] effectively exempting [the foreign investor] from U.S. tax on the gain realized on disposition of the property.[218]

The Committee, quite obviously, tried to eschew any motive other than erasing this inequality of tax treatment and justified this single objective by invoking the principle of "horizontal equity," the idea that persons who are similarly situated should be taxed similarly.[219]

But it is not so clear that this principle really applies to domestic and foreign taxpayers. Domestic taxpayers, after all, enjoy all of the protections and benefits of United States law and participate fully in the commercial life of this country. Foreign investors who do not engage in a United States "trade or business," on the other hand, are prototypically passive. Their involvement in United States commercial activity is not ongoing and extensive, or else they would probably be taxable even under pre-FIRPTA law.[220] These investors,

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214. I.R.C. §§ 871(b)(1), 882(a)(1), 1001(c) (1976 & Supp. V 1981). For nonresidents, the gain must also be "effectively connected" with the taxpayer's United States trade or business. *Id.* § 864(c)(1)(A), (2) (1976). *See generally supra* notes 32-87 and accompanying text (discussing pre-FIRPTA taxation of foreign investments in United States land).

215. *See* I.R.C. §§ 1221, 1222 (1976 & Supp. V 1981). *See generally* 2 B. BITTKER, *supra* note 37, ch. 50 (taxation of capital gains and losses).

216. *See supra* notes 40-57 and accompanying text (discussing "trade or business" determination).

217. I.R.C. § 897(a)(1) (Supp. V 1981). *See generally supra* Part III (discussing FIRPTA provisions).

218. S. REP. No. 504, 96th Cong., 1st Sess. 6 (1979) (emphasis added). This report accompanied the bill that was subsequently enacted as FIRPTA.

Curiously enough, even dispassionate students of foreign investment policy found this inequality of tax treatment abhorrent and urged its elimination. *See, e.g.*, GAO REPORT, *supra* note 4, at 32-33; E. FRY, FINANCIAL INVASION OF THE U.S.A. 147 (1980); Sisson, *The Tax System and the Structure of American Agriculture*, 9 TAX NOTES 419, 423 (1979).

219. *See generally* 1 B. BITTKER, *supra* note 37, ¶ 3.1.4 (defining and discussing horizontal equity).

220. *See* Lewenhaupt v. Commissioner, 20 T.C. 151, 162-63 (1953) (discussing amount of ongoing

quite simply, are not similarly situated to domestic taxpayers, and disparate tax treatment for these two groups, therefore, is not necessarily inappropriate.

Moreover, even if all real estate investors are considered similarly situated, that does not foreordain equivalent tax treatment. The horizontal equity principle merely suggests such equivalency in the absence of countervailing factors. It is not hyperbole to say that the Code is awash in countervailing factors, with the result that horizontal equity is honored more in the breach than in the observance. In each breach, some reason was thought sufficient to justify disparate—usually preferential—tax treatment, whether it was to stimulate exports,[221] encourage philanthropy,[222] promote energy conservation,[223] or preserve our architectural heritage.[224] But the point is that the horizontal equity concept, even when applicable, does not preclude disparate tax treatment. It merely requires a justification for such treatment.

With respect to foreign investors, several possible justifications suggest themselves. Difficulty in enforcing taxes on nonresident, nonbusiness investors—the raison d'etre of the original exemption[225] —is certainly one. Concessions made in bilateral tax treaties might be another.[226] Still another reason for disparate tax treatment might be to encourage foreign investment in the United States. This country historically has encouraged such investments,[227] and tax incentives are a well-accepted means of doing so.[228] Thus, Congress could easily justify treating foreign and domestic taxpayers differently, even if they were thought to be "similarly situated."

But the whole notion that the purpose of FIRPTA was to correct a breach of "horizontal equity" is itself rather spurious. In point of fact, the breach persists, even after FIRPTA, whenever an investor's gains derive from listed securities, commodities, bonds, or any capital asset other than real estate.[229] If preferential treatment of foreign investors is such a pernicious affront to horizontal equity, why was its eradication limited to real estate gains? It is this

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activity needed to constitute a United States "trade or business"), *aff'd per curiam*, 221 F.2d 227 (9th Cir. 1955). *See generally supra* notes 48-57 and accompanying text (discussing *Lewenhaupt*).

221. *See* I.R.C. § 911 (1976 & Supp. V 1981) (partial exclusion of foreign source earnings of United States expatriates), *id.* §§ 991-997 (partial deferral of export profits of a "domestic international sales corporation") (1976 & Supp. V 1981). *See generally* Maiers, *The Foreign Earned Income Exclusion: Reinventing the Wheel*, 34 TAX LAW. 691 (1981) (discussing taxation of foreign earned income); Kingson, *A Somewhat Different View*, 34 TAX LAW. 737 (1981) (same); Postlewaite & Stern, *Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for Its Repeal*, 65 VA. L. REV. 1093 (1979) (same).

222. *See* I.R.C. § 170 (1976 & Supp. V 1981) (deduction for charitable contributions).

223. *See id.* § 48(*l*) (Supp. V 1981) (tax credits for investments in qualifying "energy property").

224. *See id.* § 48(g)(3) (tax credits for rehabilitating a "certified historic structure"); *see also id.* § 280B (1976 & Supp. V 1981) (denial of deduction for expenses of demolishing such structure).

225. *See supra* notes 158-59 and accompanying text.

226. *See generally supra* notes 138-55 and accompanying text (discussing intersection of FIRPTA and tax treaties).

227. *See generally* Niehuss, *Foreign Investment in the United States: A Review of Government Policy*, 16 VA. J. INT'L L. 65 (1975) (discussing United States encouragement of foreign investment); Comment, *Foreign Direct Investment in the United States: Possible Restrictions at Home and a New Climate for American Investment Abroad*, 26 AM. U. L. REV. 109 (1976) (same).

228. *See* Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539; S. REP. No. 1707, 89th Cong., 2d Sess. 9 (1966). *See generally* Choate, Hurok & Klein, *Federal Tax Policy for Foreign Income and Foreign Taxpayers: History, Analysis and Prospects*, 44 TEMP. L.Q. 441 (1971) (historical background on United States encouragement of foreign investment).

229. *See* I.R.C. §§ 871(a)(2), 881(a), 897(a)(1) (1976 & Supp. V 1981).

limitation that shows unmistakably that FIRPTA was intended to do far more than simply correct a disparity between foreign and domestic investors. Notwithstanding the statement quoted previously from the Committee Report,[230] FIRPTA was intended to discourage foreign investment in United States real estate. The question then becomes whether this statute will indeed have that effect.

B. EFFECT ON FOREIGN INVESTMENT IN UNITED STATES REAL ESTATE

Foreign investors are attracted to United States real estate for many different reasons. Among these are this country's stable political system,[231] relatively low rates of inflation, clearly articulated respect for private property, relatively inexpensive land prices,[232] and good prospects for capital appreciation.[233] Some foreign investors have additional reasons, such as securing a "safe haven" in the event that political upheaval at home necessitates a speedy departure.[234] The absence of a tax upon disposition, however, does not seem to be a major consideration; in comparison with the other factors at play, it is downright trivial.[235] After all, a tax upon disposition has absolutely no impact on a foreign investor unless he disposes of the property. Until then, any tax advantage, or "inducement" as the Committee Report called it,[236] is irrelevant.

That being the case, how can FIRPTA hope to affect foreign investment in United States land? It might deter foreign speculators perhaps, but most foreign investors come to the United States for long term, even permanent, investments.[237] To them, the panoply of relevant investment incentives—stable economy, "safe haven," and so forth—remains unchanged. Hence, FIRPTA is unlikely to affect the level of aggregate foreign investment in United States real estate to any discernible degree.

Yet, proponents of the new statute apparently believed that the capital gains exemption had not only increased aggregate foreign investment in United States real estate, but had also, by itself, precipitated higher land prices. In the words of Senator Church, one of FIRPTA's cosponsors:

> This tax loophole gives foreign investors a special advantage in the purchase of U.S. land by enabling them to pay higher prices than can any U.S. investor or farmer, who must take into consideration that he will have to pay the full capital gains tax in the event he should sell

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230. *See supra* text accompanying note 218.

231. *See* Katz, *Foreign Direct Investment in the United States—Advantages and Barriers*, 11 CASE W. RES. J. INT'L L. 473, 475-76 (1979).

232. *See* SENATE COMM. ON AGRICULTURE, NUTRITION, AND FORESTRY, 95TH CONG., 2D SESS., FOREIGN INVESTMENT IN UNITED STATES AGRICULTURAL LAND III 12 (Comm. Print 1979) (comparable land in Europe sells for 50-100% more) [hereinafter SENATE STUDY].

233. *See generally* GAO REPORT, *supra* note 4, at 68-80.

234. *See* Azrack & Roberts, *Foreign Real Estate Practices and the Economy*, in 3 U.S. DEP'T OF AGRICULTURE, MONITORING FOREIGN OWNERSHIP OF U.S. REAL ESTATE 69, 70 (1979).

235. *But see* GAO REPORT, *supra* note 4, at 69, 70 (tax advantages are consideration for small percentage of foreign investors).

236. *See supra* text accompanying note 218.

237. *See Impact of Foreign Investment in Farmland: Hearings on H.R. 13128 and Related Bills Before the Subcomm. on Family Farms, Rural Development, and Special Studies of the House Comm. on Agriculture*, 95th Cong., 2d Sess. 125-26 (1978) (statement of William A. Stiles, Senior Vice President of Oppenheimer Industries, Inc.) [hereinafter *Impact Hearings*].

or transfer the land.[238]

The validity of this proposition is open to serious question. A detailed study prepared by the General Accounting Office *before FIRPTA was enacted* found that "foreign purchasers did not consistently pay more than U.S. buyers for similar land."[239] In other words, foreign investors typically bought at market prices and did not exploit their pre-FIRPTA tax advantage by making higher bids. Even if this had not been the case, those higher prices would presumably have gone to the landowners who sold their properties to the foreign investors—usually, American citizens. But the fact remains that the tax advantage eliminated by FIRPTA was not a significant factor affecting United States real estate prices.

Alternatively, a tax-exempt foreign seller might arguably sell his property for *less* money than a domestic seller would require to achieve the same return on his investment. Assume, for example, that land purchased last year for $100 is now worth $150. A domestic investor would sell it for $150, pay a $10 tax—(20%)[240] —on his $50 capital gain ($150 less cost of $100) and achieve a 40% return on investment (after-tax profit of $40 on a $100 investment). A tax-exempt foreign seller, however, could sell the property for $140 and realize the same result. But if the property was worth $150, the foreign investor would probably sell it for that price also, without factoring in his tax exemption.[241] Moreover, even if the foreign investor did sell his parcel at the lower price, the beneficiary of this action is the purchaser, most likely an American, who obtains the parcel at a lower price. In other words, the pre-FIRPTA tax advantage often redounded to the *benefit* of domestic landowners, if it had any effect on prices at all. Inasmuch as that effect was largely illusory, however, the case for FIRPTA in terms of its reducing United States land prices (or discouraging foreign investment, for that matter) seems fairly weak.

C. FOREIGN LAND OWNERSHIP GENERALLY

Even if FIRPTA might have an effect on foreign investment in United States real estate, there are significant policy questions about the wisdom of such an enactment. Put quite simply, why should foreign investment in real estate be discouraged at all, through tax policy or otherwise? Proponents of foreign land ownership restrictions claim that such investments tend to raise the price of real estate generally,[242] jeopardize its effective utilization and pres-

238. 124 CONG. REC. 34,606 (1978) (statement of Senator Church); *see also id.* at 34,604-05 (remarks of Senator Wallop to same effect); Drinkhall & Guyon, *Real-Estate Purchases by Foreigners Climb, Stirring Wide Debate*, Wall St. J., Sept. 26, 1979, at 1, col. 1 (tax advantage thought to give foreigners some price advantage).

239. GAO REPORT, *supra* note 4, at 67. *See generally* Jansma, Goode & Small, *Economic Effects of Foreign Farmland Investments on Farms and Rural Communities*, in 3 U.S. DEP'T OF AGRICULTURE, *supra* note 234, at 1, 56-57 (no conclusive evidence that foreigners pay more for land).

240. *See* I.R.C. §§ 1, 1202(a) (Supp. V 1981) (after 60% exclusion, only 40% of gain is subject to tax; at highest tax rate of 50%, maximum capital gain tax rate becomes 20%).

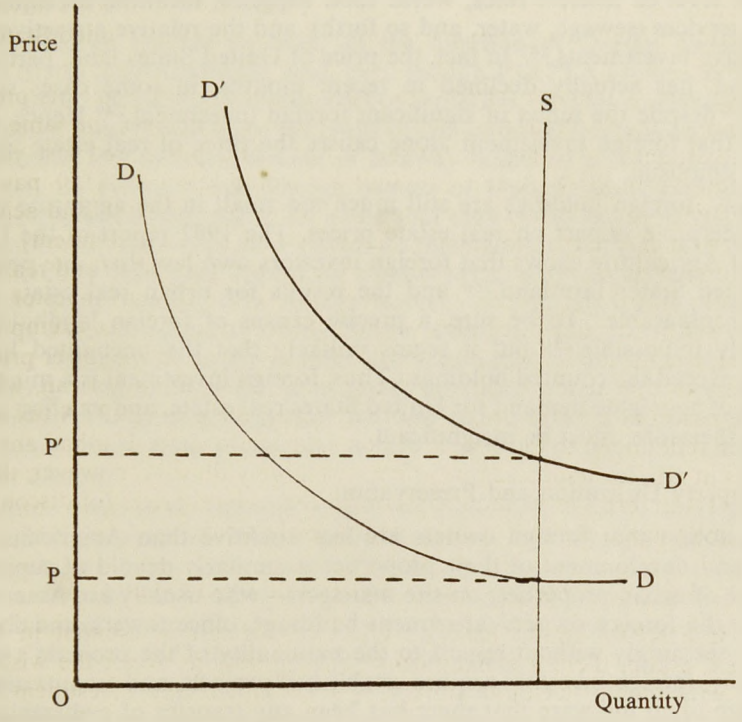
241. On the effect of a seller's tax-exempt status on his prices generally, see Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430, 1465-66 & nn.211-13 (1980).

242. *See Impact Hearings, supra* note 237, at 21 (statement of Representative Krebs); *Taxation of Foreign Investment in the United States: Hearing on S.192 and S.208 Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance*, 96th Cong., 1st Sess. 26 (1979) (statement of Senator Wallop); E. FRY, *supra* note 218, at 5.

ervation,[243] and threaten United States food supplies.[244] These contentions, however, are highly exaggerated, if not entirely specious.

1. Effect on Land Prices

As a matter of economic theory, if demand increases for a commodity whose supply is fixed, such as land, its price must rise.[245] This relationship is often set forth graphically as follows:



Where S represents the fixed supply, D' represents the increased demand over D, and P' represents the higher price (over P) that results. Thus, if foreign capital increases the demand for United States land, the price of that land can be expected to rise. This higher price, of course, would result from *any* increase in demand, not just an increase from foreign investment. If American investors increased their investments in real estate and decreased their investments in stocks and bonds, for example, the same effect on land prices would result. Foreign capital, in other words, is not terribly unique in its ability to raise real estate prices.

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243. *See* SENATE STUDY, *supra* note 232, at III; *Impact Hearings*, *supra* note 237, at 21 (statement of Representative Krebs).

244. *See* E. FRY, *supra* note 218, at 115.

245. *See* P. SAMUELSON, ECONOMICS 54-59 (11th ed. 1980); R. GILL, ECONOMICS 40-42 (3d ed. 1978). *See generally* J. HENDERSON & R. QUANDT, MICROECONOMIC THEORY 96-110 (3d ed. 1980).

In any case, there are at least three reasons why the influx of foreign capital into United States real estate should be of little concern. First, rising real estate prices are not necessarily bad, because most of the increased value of those properties accrues to domestic landholders.[246] Citizens who choose to sell their holdings benefit most directly, but other landowners also benefit from the appreciation in value of their investments.

Second, land prices are determined by many factors, not just by aggregate demand. These other factors include, among others, the availability of financing, the level of interest rates, world food supplies, location, accessibility of public services (sewage, water, and so forth), and the relative attractiveness of alternative investments.[247] In fact, the price of United States land, particularly farmland, has actually declined in recent months, in some cases substantially,[248] despite the influx of significant foreign investment.[249] Hence, the assertion that foreign investment alone causes the price of real estate to rise is overly simplistic.

Finally, foreign holdings are still much too small in the aggregate to have any discernible impact on real estate prices. The 1982 report of the Department of Agriculture shows that foreign investors own less than one percent of all United States farmland,[250] and the results for urban real estate are no doubt comparable. To be sure, a precise census of foreign landholdings is probably impossible,[251] but it seems unlikely that the uncounted holdings greatly exceed the counted holdings. Thus, foreign investment is a minor component of aggregate demand for United States real estate, and its effect on land prices, therefore, must be insignificant.

2. Property Utilization and Preservation

The notion that foreign owners are less attentive than Americans to the needs and development of their properties is similarly devoid of support. In the case of urban properties, on-site managers—who usually are Americans—operate the foreign owners' apartment buildings, office towers, and shopping centers seemingly without regard to the nationality of the property's owners. Typically, foreign investors acquire established projects, and tenants and other users are often unaware that there has been any transfer of ownership at all. There may be exceptions, of course, but for the most part, foreign investors are well-capitalized and make every effort to maintain or improve the status of their United States properties.

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246. *See* U.S. DEP'T OF AGRICULTURE, FOREIGN OWNERSHIP OF U.S. AGRICULTURAL LAND 8 (1982) (Americans own all but one percent of U.S. farmland) [hereinafter 1982 CENSUS].

247. *See generally* U.S. DEP'T OF AGRICULTURE, FARM REAL ESTATE MARKET DEVELOPMENTS 4-11 (1979) (discussing factors affecting price of farmland); Luttrell, *The "Danger" from Foreign Ownership of U.S. Farmland*, 61 FED. RES. BANK ST. LOUIS 2, 7 (1979) (same); Comment, *Economic and Political Impacts of Taxation of Foreign Investment in United States Agricultural Land*, 15 TEX. INT'L L.J. 287, 291-94 (1980) (same). Many of these factors also affect the price of urban real estate.

248. *See* Hill, *Home Prices' Plunge, Steeper Than It Seems, Could Slow Recovery*, Wall St. J., June 17, 1982, at 1, col. 6.

249. *See* 1982 CENSUS, *supra* note 246, at 13; *see also* GAO REPORT, *supra* note 4, at 43 (nonlocal United States and foreign investors acquired 24% of all farmland that was sold).

250. 1982 CENSUS, *supra* note 246, at 8.

251. Kaplan, Book Review, 129 U. PA. L. REV. 486, 488-89 (1980); *see also* 1982 CENSUS, *supra* note 246, at 59-62.

Foreign-owned agricultural properties present much the same picture, with local managers once again operating these properties in largely conventional ways. The properties do not lie fallow and in fact are often *better* maintained under the foreign investor's ownership.[252] Particularly because most foreign owners are interested in their properties' long-term prospects, the risk of underutilization or improper maintenance of foreign-owned United States real estate seems trivial at most.

3. United States Food Supplies

Emotionalism reaches its peak on the question of foreign ownership of United States food-producing land, even though FIRPTA applies to all forms of real estate, including downtown office buildings.[253] The contention here is that foreign owners will seize the fruits of our national heritage to satisfy foreign demand and alleviate famine in faraway lands. In point of fact, there is absolutely no evidence that foreign owners of United States farmland have ever contemplated such plans, let alone that they could implement them. To the contrary, these owners have shown no inclination to market their products any differently than their American counterparts, who themselves have little hesitancy about dealing with foreign buyers. In any case, foreign investors own such a small portion of United States farmland,[254] and are so unlikely to acquire a significantly larger portion any time soon,[255] that the effect of any diversion of farm produce would probably be indiscernible. Particularly when one considers the farm acreage that has been taken out of production to maintain United States farm prices, the prospect of diminishing food supplies is patently absurd.

In short, there is no rational reason to discourage foreign investment in United States real estate. Quite to the contrary, real estate is probably the safest form of foreign investment in terms of national security interests.[256] Stocks and bonds can be dumped on the market at a moment's notice, precipitating financial chaos and substantial price declines.[257] Similarly, bank deposits can be removed instantaneously, throwing even major depository institutions into insolvency,[258] as certain Arab investors have in fact threatened.[259]

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252. *See* SENATE STUDY, *supra* note 232, at 53; GAO REPORT, *supra* note 4, at 80; *see also* 1982 CENSUS, *supra* note 246, at 26, 30; U.S. DEP'T OF AGRICULTURE, FOREIGN OWNERSHIP OF U.S. AGRICULTURAL LAND 26-27 (1980); Luttrell, *supra* note 247, at 8.

253. *See* I.R.C. § 897(a), (c)(1)(A)(i) (Supp. V 1981).

254. *See* 1982 CENSUS, *supra* note 246, at 8 (foreign owners control less than one percent of U.S. farmland).

255. *See* U.S. DEP'T OF AGRICULTURE, ANALYSIS OF FOREIGN INVESTMENT IN U.S. FARMLAND (1978), *reprinted in* SENATE STUDY, *supra* note 232, at 76 (at current investment levels, foreign investors will need 19 years to acquire another 1% percent of United States farmland).

256. *See generally* Gaffney, *Social and Economic Impacts of Foreign Investment in United States Land*, 17 NAT. RESOURCES J. 377 (1977); Luttrell, *supra* note 247, at 8 (suggesting expropriation if necessary as last resort).

257. *See Foreign Investment in U.S. Understated, Private Report Says*, Wall St. J., June 23, 1981, at 18, col. 4 ("oil-exporting countries, acting as a block, could cause major disruption in the U.S. equity markets").

258. *See* Davis, *The Petrodollar Trial*, MOTHER JONES, Nov. 1980, at 20, 27.

259. *See* E. FRY, *supra* note 218, at 142 (describing an Arab threat to withdraw funds from Canadian banks should Canada move its Israeli embassy from Tel Aviv to Jerusalem).

But what can happen with land? By definition, it is fixed and immobile. Can a foreign investor remove his office building or repatriate his topsoil overnight? Would the Iranian Assets Freeze[260] have been necessary if those assets had been United States real estate holdings? Land, quite simply, is the most secure means of "recycling" foreign-held dollars, and any paranoia about foreign investments—whether justified or not—should argue for the encouragement, rather than the discouragement, of United States land acquisitions. To the extent, therefore, that FIRPTA even implies a contrary message, it is misdirected and wrong-headed.

VII. CONCLUSION

The Foreign Investment in Real Property Tax Act (FIRPTA) of 1980, as amended in 1981, is an unmitigated disaster. The "loophole" it closes was consciously created as a practical necessity and was restricted to a relatively limited class of foreign investors. To abolish this loophole, FIRPTA imposes a complex statutory regime that, despite an intrusive system of reporting requirements, is of questionable enforceability. Furthermore, for the new statute to have even facial effectiveness, it was necessary for Congress to override conflicting tax treaty provisions, a move that is without modern precedent or foreseeable long-term consequences.

Even more problematic are FIRPTA's confused policy objectives. The supposedly horrific inequity of foreign versus domestic taxation actually remains unchanged, except for the special case of real estate dispositions. The clear intention of this statute, therefore, is not to eradicate inequities, but rather to discourage foreign investment in United States real estate, a goal for which FIRPTA is singularly unsuited. In any case, the goal itself manifests a disturbing xenophobia that lacks any economic rationale or common sense foundation. The new statute, quite clearly, is flawed beyond amendatory repair and should be repealed in its entirety at the earliest opportunity.

260. Exec. Order No. 12,170, 3 C.F.R. 457 (1980), 50 U.S.C. § 1701 note (Supp. IV 1980); *see also* Dames & Moore v. Regan, 453 U.S. 654, 662-68 (1981) (describing freeze of Iranian assets).

Reforming the Bankruptcy Reform Act of 1978: An Alternative Approach

WILLIAM T. VUKOWICH*

The Bankruptcy Reform Act of 1978 has been criticized because, contrary to Congress' intentions, it fails to encourage debtors to file repayment plans in chapter 13 rather than to liquidate assets in chapter 7. Professor Vukowich analyzes a proposal of the credit industry that would deny debtors with "affordable debt" the traditional discharge of debt in chapter 7 and a proposal of the National Bankruptcy Conference that would impose an "ability-to-pay" test on debtors who choose to repay a portion of their debt in chapter 13. Professor Vukowich contends that these proposals do not serve the goals of Congress and are impractical. The article recommends that Congress reduce the amount of property a debtor may exempt in chapter 7. Professor Vukowich argues that making chapter 7 less attractive would encourage more debtors to file repayment plans in chapter 13.

The consumer credit industry has united to propose major reforms in the recently adopted Bankruptcy Reform Act of 1978.[1] Stunned by an unprecedented increase in the number of consumer bankruptcies since the new Act's effective date in October 1979,[2] the credit industry wants Congress to amend the Bankruptcy Reform Act to deny consumer debtors the traditional discharge of debt under chapter 7 of the Act[3] if the debtors have what has come to be called "affordable debt."[4] The credit industry asserts that a significant pro-

* Professor of Law, Georgetown University Law Center; A.B., 1965, University of Indiana; J.D., 1968, University of California at Berkeley; J.S.D., 1976, Columbia University.

1. Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-151326 (Supp. V 1981). If a consumer finds himself unable to meet his creditors' demands, he may seek relief by filing a voluntary petition in bankruptcy, *id.* § 301, under either chapter 7, *id.* §§ 701-706, or chapter 13, *id.* §§ 1301-1330. Under chapter 7, a debtor's nonexempt property is liquidated and the proceeds are distributed to his creditors. *Id.* § 726. Under chapter 13, a debtor retains his property and sets up a plan to repay some or all of his debt out of future income. *Id.* §§ 1321-1322. After a debtor satisfies the conditions of either chapter 7 or chapter 13, a federal bankruptcy court may relieve him of any remaining credit obligations by awarding him a discharge of debt. *Id.* §§ 727, 1328.

Consumers also may become debtors under chapter 11, *id.* §§ 1101-1174, although that chapter generally is used by businesses. D. EPSTEIN & J. LANDERS, DEBTORS AND CREDITORS 378 (2d ed. 1982). Under certain circumstances, creditors may file an involuntary petition in bankruptcy against a debtor under chapter 7 or chapter 11. 11 U.S.C. § 303 (Supp. V 1981).

2. *See Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Courts of the Senate Comm. on the Judiciary* [pt. 1], 97th Cong., 1st Sess. 1 (Apr. 3 & 6, 1981) (opening statement of Sen. Dole) (since new Act took effect, bankruptcy filing has become almost epidemic) [hereinafter *Reform Hearings*, pt. 1]; *id.* at 8, 13-14 (statement of Andrew Brimmer, credit industry consultant) (during first 12 months that new Act in effect, personal bankruptcies rose by 75%); *id.* at 106 (statement of Paul Pfeilsticker, representative of credit association) (since new Act took effect, dramatic increase in bankruptcy filings).

3. *See infra* note 37 and accompanying text (discussing chapter 7 discharge provisions).

4. *See Reform Hearings*, pt. 1, *supra* note 2, at 36 (statement of Andrew Brimmer) (proposing legislation to preclude discharge of any debt that reasonably could be repaid out of consumer's anticipated future income); *cf. Bankruptcy Reform Act of 1978 (Future Earnings): Hearings Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, pt. 2, 97th Cong., 1st Sess. 19 (Oct. 29, 1981) (statement of Robert Johnson, Director, Credit Research Center of Purdue University School of Management) (sig-

portion of debtors whose debts are now discharged under chapter 7 could pay off all or a large part of their debt over a period of five years.[5] Such debtors, the credit industry contends, ought to be required to pay their debt through repayment plans under chapter 13.[6] Even though the credit industry did not urge this position when the Bankruptcy Reform Act of 1978 was being considered, Congress deliberately rejected mandatory repayment schemes at that time.[7]

The National Bankruptcy Conference has advanced an alternative proposal, the "ability-to-pay" test, which is aimed at increasing the level of debt repayment under chapter 13.[8] Under this proposal, debtors who choose to file in chapter 13 would have to pay creditors the full amount of their projected disposable income for at least the three-year period following the bankruptcy filing.[9] The National Bankruptcy Conference proposal, unlike the credit industry proposal, allows debtors the opportunity to choose either a liquidation of nonexempt property in a chapter 7 proceeding or a repayment plan in a chapter 13 proceeding.[10]

The credit industry[11] and the press[12] point to the new law as the cause of the

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nificant number of debtors who filed for chapter 7 could have repaid some of their debts) [hereinafter *Reform Hearings*, pt. 2]; *id.* at 205-06 (statement of Paul Tongue, representative of bank associations) (requiring debtors to repay those debts within their ability to repay represents sound and equitable policy).

5. Summarizing the results of a study of consumer bankruptcies, Robert Johnson, the director of Purdue University's Credit Research Center, stated that:

> [T]here was a significant number of people who filed for chapter 7 who could have repaid some portion of their debts. For example, 29 percent could have repaid all of their nonmortgage debts in full in a 60-month period. Almost two-fifths of the people filing for chapter 7 could have paid 50 percent or more of their nonmortgage debts in a period of 60 months.

Reform Hearings, pt. 2, *supra* note 4, at 19.

6. *See infra* notes 104-12 and accompanying text (discussing consumer credit industry proposal).

7. H.R. REP. NO. 595, 95th Cong., 1st Sess. 120 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6080-81 (rejecting idea of allowing creditors to force debtors into repayment plans) [hereinafter H.R. REP. NO. 595].

8. *See Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King, New York University School of Law and representative of National Bankruptcy Conference).

9. *See infra* notes 159-68 and accompanying text (discussing National Bankruptcy Conference proposal). After the Bankruptcy Reform Act of 1978 was enacted, both the Senate and the House of Representatives considered adding a requirement that debtors' repayment plans represent their best efforts to repay creditors, much like the notion of "ability-to-pay" now proposed by the National Bankruptcy Conference. *See generally* Cyr, *The Chapter 13 "Good Faith" Tempest: An Analysis and Proposal for Change*, 55 AM. BANKR. L.J. 271, 281-86 (1981) (discussing "good faith effort" and "bona fide effort" requirements of proposed amendments); LoPucki, *"Encouraging" Repayment Under Chapter 13 of the Bankruptcy Code*, 18 HARV. J. ON LEGIS. 347, 361-63 (1981) (same). However, these proposals were never adopted and chapter 13 requires only that the plan "has been proposed in good faith." 11 U.S.C. § 1325(a)(3) (Supp. V 1981).

10. *See infra* notes 159-60 and accompanying text.

11. *See Reform Hearings*, pt. 1, *supra* note 2, at 13-18 (statement of Andrew Brimmer) (dramatic increase in bankruptcy filings following passage of new Act far in excess of what historical evidence indicated filings should be); *id.* at 154 (statement of Norman Grant, credit industry consultant) (new Act has vastly enhanced attractiveness of filing for bankruptcy); *cf. Reform Hearings*, pt. 2, *supra* note 4, at 198 (statement of Paul Tongue) (credit industry not responsible for increase in bankruptcy filings by allegedly forcing more credit on consumers).

12. *See, e.g.*, FORBES, June 22, 1981, at 14 (new bankruptcy code encourages debtors not to honor their debts); Wash. Post, July 15, 1982, at A18, col. 1 (bankruptcy has become too easy for debtors); Chris. Sci. Monitor, May 5, 1982, at 10, col. 4 (new, liberal bankruptcy law partly responsible for increase in bankruptcies); Wall St. J., May 5, 1982, at 28, col. 1 (at least 75% of increase in bankruptcies due to new law).

increased rate of bankruptcy. There is at best, however, a weak correlation between the two. In fact, the new bankruptcy law is not fundamentally different from the old law. Both laws unconditionally discharge most debtors of almost all of their debts,[13] while allowing debtors to retain a certain amount of exempt property.[14] The new law, however, does grant both a broader discharge of debt for debtors who choose to set up repayment plans under chapter 13[15] and a federal schedule of exempt property that may benefit some debtors.[16]

These slight changes hardly account for the large increase in bankruptcy filings or for all of the "abuses" alleged to occur under the new law. The major factors contributing to the increase in filings have been the downturn in the economy[17] and consumers overextending their credit obligations.[18] Lawyer advertising no doubt also has contributed to the increased rate both by better informing the public of their rights under the bankruptcy laws[19] and by attenuating the stigma of "going bankrupt."[20] The pro-debtor changes in the new law have contributed at most marginally to the increase in bankruptcy filings.

Nevertheless, the new law is not without its flaws. The law that Congress ultimately enacted contains numerous, hastily made compromises[21] because

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13. The old and new laws' discharge provisions do not vary significantly. *Compare* Bankruptcy Act, ch. 541, §§ 14(c), 17(a), 30 Stat. 544, 550-51 (1898) (formerly codified as amended at 11 U.S.C. §§ 32, 35(a) (1976)) *with* Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 727(b), 523(a) (Supp. V 1981).

14. Bankruptcy Reform Act of 1978, 11 U.S.C. § 522 (Supp. V 1981); Bankruptcy Act, ch. 541, § 6, 30 Stat. 544, 548 (1898) (formerly codified as amended at 11 U.S.C. § 24 (1976)).

15. *Compare* Bankruptcy Reform Act of 1978, 11 U.S.C. § 1328(a) (Supp. V 1981) (under new chapter 13, all debts dischargeable except alimony and child support) *with* Bankruptcy Act § 660, *enacted by* ch. 575, § 1, 52 Stat. 840, 935-36 (1938) (formerly codified as amended at 11 U.S.C. § 1060 (1976)) (under old chapter 13, all debts dischargeable except, among others, taxes, alimony, child support, and liability for willful and malicious torts or breach of promise to marry). Under the current law, chapter 13 also permits discharge of more debts than does chapter 7. *Compare* 11 U.S.C. § 1328(a) (Supp. V 1981) (under chapter 13, all debts dischargeable except alimony and child support) *with id.* § 523(a) (under chapter 7, all debts dischargeable except taxes, alimony, child support, educational loans, liability for willful and malicious torts, and debts arising from obtaining credit or property through fraud).

16. Under section 522, a debtor may elect either state or federal schedules of exempt property unless his state has denied its residents the right to choose the federal exemptions. 11 U.S.C. § 522(b) (Supp. V 1981); *see infra* notes 34-36 and accompanying text (discussing relationship between state and federal exemptions). The federal exemption schedule may be especially beneficial to married debtors because it applies to the husband and wife separately even though a joint petition is filed. 11 U.S.C. § 522(m) (Supp. V 1981); *see infra* notes 80-84 and accompanying text (discussing married debtors exemptions).

17. *See Reform Hearings*, pt. 2, *supra* note 4, at 158 (letter from Judge Gandy, President of National Conference of Bankruptcy Judges) (adverse economic conditions, lawyer advertising, and decrease in stigmatization of bankruptcy have caused increase in bankruptcy filings); Chris. Sci. Monitor, May 18, 1982, at 6, col. 1 (increase in bankruptcy has coincided with growth of recession); N.Y. Times, May 18, 1982, at D2, col. 1 (increase in personal bankruptcy may be blamed on economy).

18. *See Reform Hearings*, pt. 2, *supra* note 4, at 185-92 (letter from Judge Lee) (increase in bankruptcies due to economic conditions and overabundance of consumer credit); *Reform Hearings*, pt. 1, *supra* note 2, at 18, 19 (debtors surveyed by creditors' consultants indicate "using too much credit" is primary reason for their bankruptcies; 57.5% list it as one reason); *see also infra* note 146 (citing additional authorities).

19. *Reform Hearings*, pt. 1, *supra* note 2, at 298-300 (statement of Richard Levin, attorney) (increase in attorney advertising for bankruptcy services is one cause of rise in bankruptcy filings); *id.* at 107 (statement of Paul Pfeilsticker) (same); *Reform Hearings*, pt. 2, *supra* note 4, at 157 (statement of Judge Gandy) (same).

20. *Reform Hearings*, pt. 2, *supra* note 4, at 156-57 (statement of Judge Gandy) (stigma associated with bankruptcy has diminished); *Reform Hearings*, pt. 1, *supra* note 2, at 110 (statement of Paul Pfeilsticker) (no longer any social stigma in filing for bankruptcy).

21. At the most recent Senate hearings on bankruptcy reform, Senator DeConcini acknowledged that the new bankruptcy law's "frenzied last-minute passage also resulted in numerous technical errors and policy misjudgments." *Reform Hearings*, pt. 2, *supra* note 4, at 8 (statement of Sen. DeConcini); *see*

different Congressmen seemed to have had different goals for the Bankruptcy Act. Moreover, many Congressmen might not have fully understood the intricacies of bankruptcy law. As a result, the bankruptcy law, like other complex statutory schemes, contains loopholes that lead to a handful of cases that not only are inconsistent with the spirit of the bankruptcy laws but are outright outrageous. For example, in a currently pending chapter 13 case, a wealthy man who was convicted of shooting and brutally beating a teenage girl with a claw hammer may obtain a discharge in bankruptcy of possible tort liability to the victim while remaining very wealthy.[22] In another case, a husband and wife may be able to discharge millions of dollars of debt while retaining over three million dollars of property.[23] Although these egregious examples represent only a small fraction of bankruptcy cases, they confirm that the new law does have loopholes.[24] In order to prevent public distrust of bankruptcy, in particular, and legal institutions, in general, these loopholes should be closed.

Perhaps more significant than these isolated "loophole" cases is the new law's failure to achieve the important congressional goal of promoting more substantial repayment of debt under chapter 13.[25] Although Congress believed it had created incentives to achieve high levels of repayment, chapter 13 in fact encourages debtors to do just the opposite.[26]

This article first presents a brief discussion of the operation of the Bankruptcy Reform Act of 1978 as it applies to consumers. It then analyzes the primary failures of the new Act in the context of consumer bankruptcies. Next, the article critically analyzes the reform proposals advanced by the consumer credit industry and the National Bankruptcy Conference. Finally, the article argues that the most effective way to reform the Act would be to reduce the amount of property a debtor may exempt under chapter 7. This alternative approach should close the existing loopholes in chapter 7 as well as result in greater use of and larger repayment plans in chapter 13.

I. OVERVIEW OF CONSUMER BANKRUPTCIES UNDER THE NEW ACT

Congress "modernized" the bankruptcy laws in 1978, in large part motivated by the vast extension of consumer credit in the past few decades.[27] Al-

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Kennedy, *Foreward: A Brief History of the Bankruptcy Reform Act*, 58 N.C.L. REV. 667, 678-79 (1980) (House and Senate resolved differences on Bankruptcy Reform Act of 1978 while under tremendous pressures).

22. *See* Wash. Post, Feb. 16, 1982, at A8, col. 1. Under chapter 13, a debtor may be discharged of debt arising from his willful and malicious tort liability. 11 U.S.C. §§ 523(a)(5), 1328(a) (Supp. V 1981). Because this debtor is supported by a family trust, which presumably has spendthrift provisions, his estate does not succeed to his rights in the trust. *See infra* note 78 and accompanying text (discussing exempting debtors' interests in spendthrift trusts).

23. *In re* Trickett, 14 Bankr. 85, 89-90 (Bankr. W.D. Mich. 1981).

24. Admittedly, these are rare cases. Nevertheless, exemptions allowed to debtors in the normal run of cases often are inordinate and generally result in creditors receiving less than they would have received if the exemptions were more modest.

25. *See* H.R. REP. NO. 595, *supra* note 7, at 118, 121, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6077-79, 6082 (new law designed to encourage greater use of chapter 13 repayment plans); SENATE COMM. ON THE JUDICIARY, BANKRUPTCY REFORM ACT OF 1978, S. REP. NO. 989, 95th Cong., 2d Sess. 13 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5799 (same) [hereinafter S. REP. NO. 989]; *Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King) (same).

26. *See infra* notes 56-73 and accompanying text.

27. *See* H.R. REP. NO. 595, *supra* note 7, at 3-4, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at

though the 1978 Act brought about many changes, the modernization did not significantly alter the basic scheme of consumer bankruptcies.

Very generally,[28] the new law allows consumer-debtors to elect to file in either chapter 7 or chapter 13.[29] Under chapter 7, debtors' nonexempt assets are sold and creditors are paid from the proceeds of the sale.[30] Secured creditors fare better than unsecured creditors because the Bankruptcy Act generally respects their secured status by giving them "secured claims" in an amount equal to the value of their collateral.[31] When filing under chapter 7, debtors may exempt certain property, thereby preventing that property from being liquidated to satisfy creditors' claims.[32] Section 522(b), which prescribes the exemptions available in chapter 7, authorizes debtors to select either the federal schedule of exempt property in section 522(d)[33] or the schedule of exempt property provided by the law of the state in which they reside.[34] Section 522(b) further provides, however, that states may deny their residents the right to select the federal exemptions.[35] To date, thirty-four states have enacted legislation that prohibits resident-debtors from selecting the federal exemptions.[36]

5965 (modernization required because of growth of commercial credit after many states adopted Uniform Commercial Code); S. REP. NO. 989, *supra* note 25, at 2, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5788 (modernization of bankruptcy law required because of changes in creditor-debtor relationship and spread of consumer credit).

28. For more detailed discussions of consumer bankruptcies, see generally Cohen & Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N.C.L. REV. 681 (1980); Wickham, *Chapter 7 or Chapter 13: Guiding Consumer Debtor Choice Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 815 (1980).

29. 11 U.S.C. § 109 (Supp. V 1981) (defining what kinds of debtors may file under each chapter); *id.* § 301 (voluntary cases commenced by debtors filing petition under particular chapter); *cf. id.* § 303 (involuntary cases commenced by creditors meeting certain prerequisites and filing petition under chapter 7 or chapter 11).

30. *Id.* § 726.

31. *Id.* § 506(a); *cf. id.* § 522(f) (voiding nonpurchase money security interests in certain exempt property).

32. *Id.* § 522(b).

33. *Id.* § 522(d).

34. *Id.* § 522(b).

35. *Id.* § 522(b)(1).

36. *See* ALA. CODE § 6-10-11 (Supp. 1981); ARIZ. REV. STAT. ANN. § 33-1133 (Supp. 1981); ARK. STAT. ANN. § 36-210 (Supp. 1981); COLO. REV. STAT. § 13-54-107 (Supp. 1981); DEL. CODE ANN. tit. 10, § 4914 (Supp. 1981); FLA. STAT. ANN. § 222.20 (West Supp. 1982); GA. CODE ANN. § 51-1601 (Supp. 1981); IDAHO CODE § 11-609 (Supp 1982); ILL. ANN. STAT. ch. 52, § 101 (Smith-Hurd Supp. 1981); IND. CODE ANN. § 34-2-28-0.5 (Burns Supp. 1982); IOWA CODE ANN. § 627.10 (West 1981); KAN. STAT. ANN. § 60-2312 (Supp. 1981); KY. REV. STAT. § 427.170 (Supp. 1982); LA. REV. STAT. ANN. § 13:3881(B) (West Supp. 1982); ME. REV. STAT. ANN. tit. 14, § 4426 (Supp. 1982); MD. CTS. & JUD. PROC. CODE ANN. § 11-504(g) (Supp. 1982); MONT. CODE ANN. § 31-2-106 (1981); 1982 Mo. Legis. Serv. 814 (Vernon); NEB. REV. STAT. §§ 25-15, -105 (Supp. 1981); NEV. REV. STAT. § 21.090(3) (1982); N.H. REV. STAT. ANN. § 511:2-a (Supp. 1981); Act of June 2, 1981, ch. 490, § 1, 1981 N.C. Adv. Legis. Serv. No. 6 at 20 (to be codified at N.C. GEN. STAT. § IC-1601(f)); N.D. CENT. CODE § 28-22-17 (Supp. 1981); OHIO REV. CODE ANN. § 2329.662 (Page 1981); OKLA. STAT. ANN. tit. 31, § 1(B) (West Supp. 1982); OR. REV. STAT. § 23.305 (1981); S.C. CODE ANN. § 15-41-425 (Law. Co-op. Supp. 1982); S.D. COMP. LAWS ANN. § 43-45-13 (Supp. 1982); TENN. CODE ANN. § 26-2-112 (Supp. 1980); UTAH CODE ANN. § 78-23-15 (Supp. 1981); VA. CODE § 34-3.1 (Supp. 1982); W. VA. CODE § 38-10-4 (Supp. 1982); WYO. STAT. § 1-20-109 (Supp. 1982). Alaska recently enacted opt-out legislation. *See* West's Legislative Update, 24 Bankr. yellow pages 15 (January 11, 1983).

California requires residents who file a joint bankruptcy petition to elect the same exemptions, either state or federal, thus prohibiting one spouse choosing the federal exemptions and the other spouse choosing the state exemptions. CAL. CIV. PROC. CODE § 690(b) (West Supp. 1981); *see infra* notes 81-84 and accompanying text (criticizing ability of joint debtors to get "double" exemption when one may choose state exemptions and other may choose federal exemptions). One commentator has questioned

After the proceeds from the sale of nonexempt property have been distributed to creditors, debtors are discharged in chapter 7 from all remaining debts except, very generally, those for taxes, alimony, child support, educational loans, liability for willful and malicious torts, and debts arising from obtaining credit or property through false statements.[37]

When debtors elect to file in chapter 13 instead of in chapter 7, they are allowed to retain all of their property.[38] Chapter 13 debtors must propose plans that provide for partial or full repayment of creditors' claims out of their future income over a specified period of time.[39] The plans must provide for full payment of priority claims,[40] which in the consumer context usually will be only tax claims that would not be dischargeable in chapter 7.[41] The plans also must provide for payments to secured creditors in amounts at least equal to the value of the collateral securing their claims.[42] Unsecured creditors must be paid at least the amounts they would receive if the debtor's estate were liquidated under chapter 7.[43] Furthermore, debtors must propose plans in good faith[44] and obtain court approval of their plans.[45]

Debtors who complete all payments required by their plans are discharged of the remaining unpaid balances of debts except alimony or support claims.[46] Debtors who fail to complete their plans remain liable for the balances on all debts enforceable against them unless the debtors qualify for a "hardship discharge."[47] In such cases, only those debts dischargeable under chapter 7 will be discharged.[48]

Although the new law does not limit the frequency with which debtors may use chapter 13, it does limit the frequency with which debtors may qualify for discharges under chapter 7. Debtors granted either a discharge under chapter 7

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whether this is an appropriate exercise of a state's opt-out power in light of section 522(m)'s provision that "[t]his section shall apply separately with respect to each debtor in a joint case." *See* Woodward, *Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO ST. L.J. 335, 344 n.66 (1982) (discussing 11 U.S.C. § 522(m) (Supp. V 1981)).

The opt-out statutes in Illinois and Tennessee had been declared void under the Supremacy Clause of the United States Constitution on the ground that they conflicted with the policy of section 522 of the Bankruptcy Act. *See In re* Balgemann, 16 Bankr. 780, 783-84 (Bankr. N.D. Ill. 1982); *In re* Rhodes, 14 Bankr. 629, 634-35 (Bankr. M.D. Tenn. 1981). However, the holdings of both cases have been reversed by courts of appeals which declared the respective opt-out statutes to be valid. *See* Rhodes v. Stewart, No. 81-5820, slip op. at 10 (6th Cir. Apr. 11, 1983); *In re* Sullivan, 680 F.2d 1131, 1138 (7th Cir. 1982).

37. 11 U.S.C. §§ 727(a), (b), 523(a) (Supp. V 1981).

38. *Id.* § 1306(b) (chapter 13 debtor retains all property unless confirmed plan provides otherwise).

39. *Id.* § 1322. Under chapter 13, repayment plans may last no longer than three years. *Id.* § 1322(c). A court may, however, upon a finding of cause approve a plan longer than three years but in no case longer than five years. *Id.*

40. *Id.* § 1322(a)(2); *see id.* § 507 (listing priority claims).

41. Under section 507(a)(6), certain unsecured tax liabilities are given a priority status. *Id.* § 507(a)(6). These tax claims are not discharged in a chapter 7 proceeding. *Id.* §§ 523(a)(1)(A), 727(a), (b).

42. *Id.* § 1325(a)(5).

43. *Id.* § 1325(a)(4). For a discussion of whether the "good faith" provision of section 1325(a)(3) requires that even greater payments be made to unsecured creditors, see *infra* notes 58-60 and accompanying text.

44. 11 U.S.C. § 1325(a)(3) (Supp. V 1981). The section provides that: "[T]he court shall confirm a plan if . . . the plan has been proposed in good faith and not by any means forbidden by law." *Id.*

45. *Id.* § 1325(a).

46. *Id.* §§ 1328(a), 523(a)(5).

47. *Id.* § 1328(b), (c).

48. *Id.* §§ 1328(c)(2), 523(a).

or a discharge of a significant amount of debt under chapter 13 within the preceding six years may not receive a chapter 7 discharge.[49]

II. PRIMARY SHORTCOMINGS OF THE NEW ACT

A. THE FAILURE OF CHAPTER 13

Contrary to Congress' intentions,[50] fewer debtors than hoped for are using chapter 13 to repay large portions of their debt. Less than thirty percent of debtors elect chapter 13.[51] When debtors do elect chapter 13, only nominal payments are made to creditors who have nonpriority, unsecured claims.[52] Although significant payments may be made to secured[53] and priority creditors,[54] they would receive nearly the same payments even if the debtor elected chapter 7 or filed no bankruptcy petition at all.[55] Accordingly, the focus must be

49. *Id.* § 727(a)(8), (9). A debtor may be entitled to a chapter 7 discharge even after having obtained a chapter 13 discharge within the last six years if, under his chapter 13 plan, he paid 100% of unsecured claims or 70% of unsecured claims and the plan was proposed in good faith and represented the debtor's best effort. *Id.* § 727(a)(9).

50. *See supra* note 25 and accompanying text.

51. In 1981, 88,117—or almost 28%—of all nonbusiness bankruptcies were filed in chapter 13 and 226,602 were filed in chapter 7. JUDICIAL CONFERENCE OF THE UNITED STATES, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, Table F3B (1982) (copy on file at *Georgetown Law Journal*). Although this percentage is not high in absolute terms, it does show a significant increase in the rate of chapter 13 filings compared to, for example, the number filed in the 1976-77 fiscal year. In that fiscal year, 180,062 cases were filed in chapter 7 and only 29,422 cases, or less than 15%, were filed in chapter 13. JUDICIAL CONFERENCE OF THE UNITED STATES, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, Table F2 at 466 (1977) (copy on file at *Georgetown Law Journal*).

52. A consultant to the credit industry has stated that "under Chapter 13, a very high fraction of the indebtedness is repayed." *Reform Hearings*, pt. 1, *supra* note 2, at 29 (statement of Andrew Brimmer). This conclusion is not based on an actual analysis of chapter 13 cases, but instead is based on the fact that "lenders have reported to us that bankrupt customers filing under chapter 13 repay about 60 to 70 percent of their debts." *Id.* at 10. Even if they are accurate, these percentages are misleading. For reasons discussed in the text following this note, the relevant inquiry should be the extent of repayment on unsecured claims since secured and priority claims would be paid in any event. Hence, the 60% or 70% figures must represent mostly secured and, to some extent, priority claim payments. Although statistical evidence on the level of repayment on unsecured claims in chapter 13 cases is sparse, a different credit industry spokesman has indicated that the level is quite low. *See Reform Hearings*, pt. 2, *supra* note 4, at 223-25 (statement of Paul Tongue) (53% of plans repay 5% or less of debts). Bankruptcy judges also have commented that the level of repayment is quite low. *See In re* Ciotta, 4 Bankr. 253, 255 (Bankr. E.D.N.Y. 1980) (few plans provide for repayment of more than 50% of unsecured debt; in majority of cases, creditors fare only slightly better under chapter 13 than chapter 7); *In re* Hurd, 4 Bankr. 551, 559 (Bankr. W.D. Mich. 1980) (effect of new chapter 13 shocking because of large number of low repayment plans).

53. Under chapter 13, either the debtor must pay a secured creditor the full amount of the claim or surrender the collateral, 11 U.S.C. § 1325(a)(5)(B), (C) (Supp. V 1981), or the secured creditor must accept the proposed plan. *Id.* § 1325(a)(5)(A).

54. Debtors proceeding under chapter 13 must pay 100% of all priority claims. *Id.* § 522(a)(2). The only claims having priority status that are likely to be incurred by chapter 13 debtors are tax claims. *See id.* § 507(a)(6) (giving priority status to tax claims). It is unlikely that chapter 13 debtors would be liable for other claims that would have priority, such as claims of wage-earners, *id.* § 507(a)(3), (4), or claims of buyers of consumer products. *Id.* § 507(a)(5).

55. If a debtor files under chapter 7, secured creditors are assigned "secured claims" up to the amount of the value of their collateral. *Id.* § 506(a). If a debtor filed no bankruptcy petition at all, the secured creditor may repossess and the collateral thereby satisfys his claim. *See generally* U.C.C. §§ 9-501 to 9-507 (1972). Tax claims, the most likely priority claim against consumer-debtors filing under chapter 7, either would be paid under chapter 7, 11 U.S.C. § 726(a)(1) (Supp. V 1981), or would remain a liability of the debtor because tax claims are nondischargeable. *Id.* § 523(a)(1)(A); *cf. In re* Frost, 19 Bankr. 804, 808-09 (Bankr. D. Kan. 1982) (unsecured priority tax claims nondischargeable if they arise within statutorily-defined time period).

placed on repayment of unsecured, nonpriority claims in order to increase payments in chapter 13.

Chapter 13 requires that debtors propose to pay unsecured claims in at least the amount that would have been paid if the debtor had elected chapter 7.[56] In practice, however, this requirement is of little significance in most cases because the average debtor may exempt most, if not all, of his assets in chapter 7.[57] Dissatisfied with the low level of repayment permitted by this provision of chapter 13, many bankruptcy court judges have construed chapter 13's "good faith" provision[58] to require that debtors' plans provide for "substantial" or "meaningful" repayment of unsecured debt.[59] Almost all the courts of appeals that have addressed the issue, however, have rejected this construction of the "good faith" provision. The appellate courts generally have held that the amount of repayment to unsecured creditors is only one factor to consider in determining whether a plan has been proposed in good faith.[60]

Not only does chapter 13 require only minimal repayment of unsecured claims, but the discharge provisions actually discourage debtors from proposing substantial repayment plans, even if they otherwise might be ethically or altruistically inclined to pay creditors more than the minimum required. First, to be certain of obtaining a discharge, chapter 13 debtors must complete all payments provided by their court-approved plans.[61] Consequently, because discharge is so important, debtors and their attorneys have a strong incentive

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56. 11 U.S.C. § 1325(a)(4) (Supp. V 1981).

57. *See id.* § 522(b), (d) (providing exemption schedules); *Reform Hearings*, pt. 1, *supra* note 2, at 36 (statement of Andrew Brimmer) (in 90% of chapter 7 cases, debtor had no reachable assets; unsecured creditors therefore received nothing); Shuchman & Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1, 7-8 (1982) (debtors in only 6.1% of cases studied had significant assets).

58. 11 U.S.C. § 1325(a)(3) (Supp. V 1981); *see supra* note 44 (quoting good faith provision).

59. *See In re* Fredrickson, 5 Bankr. 199, 201 (Bankr. M.D. Fla. 1980) (requiring "meaningful" payments to unsecured creditors); *In re* Raburn, 4 Bankr. 624, 625 (Bankr. M.D. Ga. 1980) (requiring payment of 70% of unsecured claims); *In re* Anderson, 3 Bankr. 160, 163 (Bankr. S.D. Cal. 1980) (requiring "fair and reasonable" payments to unsecured creditors); *In re* Campbell, 3 Bankr. 57, 59-60 (Bankr. S.D. Cal. 1980) (requiring "substantial" payments to unsecured creditors); *see also* Note, *Abusing Chapter 13 of the Bankruptcy Code: The Problem of Nonrepayment*, 55 N.Y.U. L. REV. 941, 954 (1980) (noting bankruptcy court decisions construing good faith provision to require substantial payments to unsecured creditors). *Contra In re* Blossfeld, 13 Bankr. 534, 537 (Bankr. N.D. Ill. 1981) (good faith provision does not require substantial, meaningful payments, but only payments that debtor seemingly able to make); *In re* Harper, 11 Bankr. 395, 396-97 (Bankr. N.D. Ga. 1981) (approving plan paying one percent to unsecured creditors as made in good faith); *In re* Cloutier, 3 Bankr. 584, 586-87 (Bankr. D. Colo. 1980) (approving plan paying zero percent to unsecured creditors as made in good faith; legislative history does not show that any particular level of payment required). *See generally In re* Scher, 12 Bankr. 258, 260-76, 280-83 (Bankr. S.D.N.Y. 1981) (discussing legislative history and courts' construction of good faith provision); Cyr, *The Chapter 13 "Good Faith" Tempest: An Analysis and Proposal for Change*, 55 AM. BANKR. L.J. 271, 272-85 (1981) (same); Note, *"Good Faith" and Confirmation of Chapter 13 Composition Plans: Analysis and a Proposal*, 65 MINN. L. REV. 659, 665-79 (1981) (same); Note, *Payments to Unsecured Creditors Under Chapter 13 of the Bankruptcy Reform Act of 1978*, 57 IND. L.J. 189, 193-206 (1982) (same). The Eighth Circuit has reversed a bankruptcy court's approval of a plan proposing to pay zero percent to unsecured creditors because the plan was not made in good faith. *In re* Terry, 630 F.2d 634, 635 (8th Cir. 1980).

60. *See In re* Deans, 692 F.2d 968, 970-72 (4th Cir. 1982) (no particular level of payment required to meet good faith requirement); *In re* Estus, 695 F.2d 311, 316-17 (8th Cir. 1982) (same); *In re* Barnes, 689 F.2d 193, 198-200 (D.C. Cir. 1982) (same); *In re* Goeb, 675 F.2d 1383, 1388-90 (9th Cir. 1982) (same); *In re* Rimgale, 669 F.2d 426, 431-32 (7th Cir. 1982) (same); *cf. In re* Terry, 630 F.2d 634, 635 & n.3 (8th Cir. 1980) (plan proposing to pay nothing to unsecured creditors not made in good faith).

61. 11 U.S.C. § 1328(a) (Supp. V 1981).

to propose repayment plans that are the easiest to complete. In fact, experience under the new law demonstrates that those chapter 13 debtors who successfully completed plans and earned discharges had proposed repayment levels that were significantly less than those proposed by debtors who did not complete their plans.[62]

The second way that the Act discourages debtors from proposing substantial plans is ironical. Congress designed chapter 13 with the expectation that more substantial payments to creditors would be made through chapter 13 repayment plans than through chapter 7 liquidations.[63] Congress accordingly sought to encourage debtors to file under chapter 13 by allowing more debts to be discharged under chapter 13 than under chapter 7.[64] Ironically, debtors who have debts that would be nondischargeable in chapter 7 but dischargeable in chapter 13 have the strongest incentive to file the easiest repayment plans because, if they fail to complete their plans, they will not qualify for the broad chapter 13 discharge. Instead, they will be required to pay the debts that are nondischargeable under chapter 7, regardless of whether they qualify for a hardship discharge under chapter 13,[65] convert the case to chapter 7,[66] or have the case dismissed.[67]

Even debtors who do not have nondischargeable chapter 7 debt have an incentive to file minimal repayment plans. As stated above, there is greater certainty of completing plans with low repayment requirements and thereby qualifying for a discharge of remaining debt.[68] Debtors who do not complete their plans may still be eligible for a discharge of debt either by qualifying for a hardship discharge under chapter 13[69] or by converting the case to chapter

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62. *See Reform Hearings*, pt. 2, *supra* note 4, at 51 (statement of Claude Rice) (proposed repayment levels 5% to 20% higher for debtors who did not complete plans than for debtors who did).

63. *See supra* note 25 and accompanying text.

64. *Compare* 11 U.S.C. §§ 1328(a)(2), 523(a)(5) (Supp. V 1981) (under chapter 13, all debts dischargeable except alimony and child support) *with id.* §§ 727(b), 523(a) (under chapter 7, all debts dischargeable except taxes, alimony, child support, educational loans, liability for willful and malicious torts, and debts arising from obtaining credit or property through fraud).

65. *Id.* § 1328(b), (c)(2).

66. *Id.* § 1307(a) (debtors may convert chapter 13 case to chapter 7 case at any time); *id.* §§ 727(b), 523(a) (describing dischargeable debts under chapter 7).

67. *Id.* § 1307(b) (on request of debtor, court shall dismiss chapter 13 case at any time).

68. *See supra* note 62 and accompanying text.

69. 11 U.S.C. § 1328 (b), (c) (Supp. V 1981). These subsections provide that:

> (b) At any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if—
>
> (1) the debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable;
>
> (2) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 of this title on such date; and
>
> (3) modification of the plan under section 1329 of this title is not practicable.
>
> (c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt—
>
> (1) provided for under section 1322(b)(5) of this title; or
>
> (2) of a kind specified in section 523(a) of this title.

Id.

7.[70] Qualifying for a hardship discharge, however, is problematic,[71] and therefore risky. Furthermore, conversion to chapter 7 may not be possible for debtors who have received a discharge within six years[72] and may be unacceptable to debtors who own valued nonexempt assets.[73] Consequently, although chapter 13 was envisioned as a device for promoting substantial payments on unsecured claims, in practice it discourages debtors from proposing ambitious repayment plans. Because debtors have a strong incentive to qualify for a chapter 13 discharge, they propose plans that they are sure they can complete.

B. THE IMPACT OF SECTION 522'S EXEMPTIONS

Under section 522(b), debtors may select either federal exemptions provided in section 522(d) or their state's exemptions unless the state of their residence has denied them the right to select the federal exemptions.[74] In practice, section 522 permits abuses in chapter 7 and affects both the rate of use of and repayment levels in chapter 13.

1. The Impact of Section 522 in Chapter 7

> *One may sojourn on the beaches of the gold coast of Florida with property values reaching to the stars and keep a homestead of unlimited value free of claims of the trustee or creditors.*[75]

The exemption provision that applies in liquidation proceedings under chapter 7 has been responsible for some of the more notorious cases under the new Act, such as the ones noted above.[76] There is no sound reason for the Act to exempt, without any limitation whatsoever, property held as a tenancy by the entirety[77] or to effectively exempt debtors' interests in "spendthrift trusts."[78] Granting debtors exemptions for such property, in addition to the ample exemptions available under section 522(d) or state law, is inordinate.[79]

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70. *Id.* § 1307(a).

71. *See id.* § 1328(b). Debtors cannot be certain that the court will find that their failure to complete the plan was due to circumstances for which they should not be held accountable.

72. *See id.* § 727(a)(9); *supra* note 49 and accompanying text (discussing limits on discharges under chapter 7).

73. *Compare* 11 U.S.C. §§ 541, 363(b) (Supp. V 1981) (under chapter 7, trustee in bankruptcy may sell or lease nonexempt property to satisfy creditors' claims) *with id.* § 1306(b) (under chapter 13, debtor retains all property unless repayment plan provides otherwise).

74. *Id.* § 522(b)(1), (d); *see supra* note 36 (citing state statutes prohibiting election of federal exemptions pursuant to § 522(b)(1)).

75. *In re* Collins, 19 Bankr. 874, 876 (Bankr. M.D. Fla. 1982).

76. *See supra* notes 22-23 and accompanying text; *see also infra* notes 79 and 84-85 and accompanying text (discussing other cases in which excessive exemptions were taken).

77. *See* 11 U.S.C. § 522(b)(2)(B) (Supp. V 1981); *see also* Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769, 792-93, 804 (1980) (arguing that unlimited exemption for property held as tenancy by the entirety indefensible).

78. *See* 11 U.S.C. § 541(c)(2) (Supp. V 1981). This subsection provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." *Id.*; *see also* Vukowich, *supra* note 77, at 777-78, 804 (arguing that exempting spendthrift trusts, which are protected to some extent in 40 states, creates unjustified and irrational diversion of assets).

79. *See In re* Redmond, 15 Bankr. 437, 438-39 (Bankr. E.D. Tenn. 1981) (home, industrial building, and lot with equity in excess of $160,000 exempted because held as tenancy by the entirety); *In re* Wilson, 3 Bankr. 439, 440, 445 (Bankr. W.D. Va. 1980) ($162,000 spendthrift trust exempted); *In re* Trickett, 14 Bankr. 85, 86-90 (Bankr. W.D. Mich. 1981) (debtor claimed that property valued at

Excessive exemptions also occur as a result of section 522(m), which authorizes husbands and wives who file joint petitions to each take separate exemptions.[80] For example, one spouse may choose state exemptions while the other chooses federal exemptions,[81] or both may choose the federal exemptions.[82] Both state exemption laws and the federal exemptions under section 522(d) have been drafted to provide family protection.[83] Thus, either scheme by itself, and applied once to each family unit, provides adequate protection. To allow the family to enjoy what amounts to double protection in joint cases is excessive.[84]

Allowing debtors to elect state exemptions, in addition to leading to excessive exemptions,[85] is bad policy.[86] State exemptions should serve a different function than bankruptcy exemptions: they should protect debtors against creditors seizing their property during passing misfortunes but while the debtors are expecting to repay their debts.[87] Autoworkers, farmers, executives, and schoolteachers temporarily may fall on hard times due to lay-offs, slow-downs,

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$3,700,000 exempt because owned as tenancy by the entirety; court held that part of property available to joint creditors whose claims totaled $105,000).

80. 11 U.S.C. § 522(m) (Supp. V 1981).

81. *E.g., In re* Cannady, 653 F.2d 210, 213-14 (5th Cir. 1981); *In re* Emmerich, 19 Bankr. 666, 667 (Bankr. 9th Cir. 1982); *In re* Carstens, 8 Bankr. 524, 527 (Bankr. N.D. Iowa 1981).

82. *In re* Lambert, 10 Bankr. 11, 13 (Bankr. N.D. Ind. 1980); *In re* Phelmetta, 7 Bankr. 461, 464 (Bankr. D. Conn. 1980).

83. *See* 11 U.S.C. § 522(d)(1), (3), (4), (6), (9), (10)(D)-(E), 11(B)-(C), (E) (Supp. V 1981) (exempting property used by debtor or dependents). Many courts have recognized that state exemption laws were enacted to protect the debtor's family, not just the debtor. *See* Murray v. Zuke, 408 F.2d 483, 487 (8th Cir. 1969); Kennedy v. First Nat'l Bank, 107 Ala. 170, 180, 186, 18 So. 396, 397, 399 (1895); Anderson v. Anderson, 44 So. 2d 652, 655 (Fla. 1950); Iowa Mut. Ins. Co. v. Parr, 189 Kan. 475, 480, 370 P.2d 400, 404 (1962); Wilcox v. Hawley, 31 N.Y. 648, 657 (1864); Eloff v. Riesch, 14 Wis. 2d 519, 524, 111 N.W.2d 578, 581 (1961); *see also* Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 784-86 (1974); *cf.* UNIF. EXEMPTIONS ACT §§ 1(2), 4(a), 6(a)-(b), 8, 16 (1976), 13 U.L.A. §§ 1(2), 4(a), 6(a)-(b), 8, 16 (1979) (recommending uniform exemption law allowing debtor to exempt property used only by dependent). *But cf. In re* Alvarez, 14 Bankr. 940, 942 (Bankr. D. Colo. 1981) (Colorado's household goods exemption intended to apply separately to spouses).

84. As the Fifth Circuit has noted:

> [S]omething of a windfall is allowed the debtor who claims federal exemptions under the Bankruptcy Code despite his or her spouse's claim of a family exemption under state law.
>
> . . . .
>
> . . . Although in some cases the debtors in a joint bankruptcy case may thereby achieve "instant affluence" rather than just "a fresh start," we think it clear that the Congress contemplated that possibility.

In re Cannady, 653 F.2d 210, 213-14 (5th Cir. 1981). The Senate recognized the impropriety of allowing double exemptions. *See* S. REP. NO. 989, *supra* note 25, at 6, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5792 (bankruptcy law should provide fresh start, not instant affluence); *In re* Maitland, 13 Bankr. 923, 926 (Bankr. S.D. Tex. 1981) (Congress aware that permitting separate exemptions might result in substantial amounts of property being exempted but chose to allow it).

85. *See, e.g., In re* Haddad, 15 Bankr. 903, 906 (Bankr. 9th Cir. 1981) ($32,000 in life insurance proceeds exempt under state law); *In re* Holl, 13 Bankr. 918, 923 (Bankr. D. Hawaii 1981) ($30,000 cash exempt under state law); *In re* Reed, 12 Bankr. 41, 43-44 (Bankr. N.D. Tex. 1981) (before filing in chapter 7, debtor liquidated $34,000 of personal property to pay off liens on his residence; debtor then permitted to exempt homestead); *see also supra* notes 79 and 84 (citing additional examples); *cf. supra* note 75 and accompanying text (quoting *In re* Collins, 19 Bankr. 874, 876 (Bankr. M.D. Fla. 1982)).

86. *See generally* Vukowich, *supra* note 77, at 801-04; Vukowich, *The Bankruptcy Commission's Proposals Regarding Bankrupts' Exemption Rights*, 63 CALIF. L. REV. 1439, 1441-46 (1975).

87. In fact, exemption laws were first enacted in the United States during the 19th century to alleviate the plight of debtors following an economic depression. *See generally* C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY 87-88 (1935) (discussing states enacting exemption laws to protect some of debtors' property against foreclosure).

crop failures, recessions, job transitions, and government budget cuts. Once the debtors reestablish their employment or businesses, they eventually will be able to pay their debts. State exemptions should operate only as a "holding" device, preventing creditors from picking away at debtors' assets when the debtors are encountering hard times but still intend to pay off their debts. So viewed, homestead exemptions—even those which exempt debtors' equities of $45,000[88] or even $80,000[89]—and other state exemptions are tolerable. Indeed, state exemptions should and can work to prevent bankruptcy from occurring.[90] In bankruptcy, however, state exemptions are exorbitant.

In bankruptcy, debt is extinguished and future repayment is not contemplated. Accordingly, an exemption scheme serves a different purpose in bankruptcy than it does in state debtor-protection statutes. The Bankruptcy Commission recognized this important difference between the respective roles of state exemptions and bankruptcy exemptions, at least in the context of the homestead exemption.[91] Congress, however, ignored the distinction when it enacted section 522(b). Congress should have followed the Bankruptcy Commission's recommendation to enact exclusive federal exemptions[92] by adopting a uniform exemption law that would apply to all debtors in bankruptcy. An unfortunate by-product of including state exemption schemes in bankruptcy is that states now are formulating exemption laws with an eye more on bankruptcy than on more proper state interests—protecting the property of debtors and their families from execution and garnishment and thereby preventing bankruptcy.

In summary, the Bankruptcy Act's exemption scheme in many cases allows debtors to retain excessive amounts of property. Permitting the unlimited exemption of property held as a tenancy by the entirety and the effective exemption of debtors' interests in spendthrift trusts furthers no bankruptcy policy whatsoever and only dishonors the bankruptcy process. The double exemption allowed in joint cases allows families larger exemptions than are necessary. Allowing debtors to use state exemptions in bankruptcy proceedings is inappropriate because state exemptions should be used only to protect debtors

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88. CAL. CIV. CODE § 1260 (West 1982).

89. N.D. CENT. CODE § 47-18-01 (1978 & Supp. 1981). In addition, a few states limit the size but not the value of a homestead. *See* ARK. CONST. art. IX, §§ 4, 5 (exempted rural and urban homesteads may not exceed 160 acres and one acre, respectively, provided that value does not exceed $2,500; rural and urban homesteads may not be reduced below 80 acres and one-quarter acre, respectively, regardless of value); FLA. CONST. art. X, § 4(a)(1) (exempted rural and urban homesteads may not exceed 160 acres and one-half acre, respectively); OKLA. CONST. art. 12, § 1 (exempted rural homestead may not exceed 160 acres; exempted urban homestead may not exceed one acre, provided that value does not exceed $5,000; urban homestead may not be reduced below one-quarter acre regardless of value); IOWA CODE ANN. § 561.2 (West 1950) (exempted rural and urban homesteads may not exceed 40 acres and one-half acre, respectively; if value in either case is less than $500, exempted homestead may be enlarged until value reaches that amount); MINN. STAT. ANN. § 510.02 (West Supp. 1982) (exempted rural and urban homesteads may not exceed 80 acres and one-half acre, respectively). For a critical analysis of the Minnesota homestead statute, see O'Brien v. Johnson, 275 Minn. 305, 309-10, 148 N.W.2d 357, 360-61 (1967).

90. *See* Vukowich, *supra* note 83, at 786-87; Vukowich, *supra* note 77, at 802.

91. COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, REPORT, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 1, at 171 (1973) ("Since the debtor is to receive a discharge, it is inappropriate to have an unlimited homestead exemption.") [hereinafter COMM'N ON THE BANKRUPTCY LAWS REPORT].

92. *Id.* at 170-71.

who are paying their debts. These excessive exemptions in bankruptcy represent unwise policy. When creditors are paid less because debtors benefit from excessive exemptions, creditors presumably make up for these losses through increased costs to all consumers for loans, goods, and services.

2. The Impact of Section 522 in Chapter 13

The section 522 exemption provisions that apply in chapter 7 liquidation proceedings also affect proceedings under chapter 13. When reforming the bankruptcy laws in 1978, Congress intended to promote greater use of chapter 13 and to encourage larger repayments in chapter 13 plans.[93] Section 522's exemption policy, however, frustrates both congressional objectives.

Rate of Use of Chapter 13. One of the incentives for filing under chapter 13 is that debtors are able to retain *all* their assets, exempt as well as nonexempt.[94] If, however, debtors can exempt all or virtually all their assets under chapter 7,[95] chapter 13's potentially powerful incentive of retaining all assets is ineffectual. No doubt many debtors who exempt all their assets are able to do so because they own few assets.[96] In such cases, any humane exemption law would protect all their assets. In contrast, other debtors have substantial assets, but are able to exempt all of them because of very generous exemption laws. If exemptions were reduced to more reasonable levels, these debtors either would file in chapter 13 so they could retain their assets or would forego filing bankruptcy altogether.[97]

This analysis highlights the concerns of both Congress and the credit industry. As it is, chapter 7 is nearly cost-free for the large number of debtors who can exempt most of their assets and discharge debts not satisfied by liquidating their nonexempt assets. As a result, debtors use chapter 13 less than they would if chapter 7 were more costly. The credit industry fully recognizes this phenomenon, but proposes a harsh, radical way of overcoming it.[98] A more sensible alternative is to curtail the liberal exemptions available to debtors.[99] Restricting the exemptions available under chapter 7 would make it less attractive and would encourage greater use of chapter 13.

Level of Repayments in Chapter 13. Chapter 13 repayment plans will be approved only if they propose to repay unsecured claims in at least "the

93. *See In re* Polak, 9 Bankr. 502, 509 (Bankr. W.D. Mich. 1981) (purpose of Act to encourage full repayment of debts through chapter 13 plans); *see supra* note 25 and accompanying text (discussing legislative history).

94. 11 U.S.C. § 1306(b) (Supp. V 1981); *see* S. REP. NO. 989, *supra* note 25, at 141, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5927 (debtor need not surrender property unless plan requires otherwise); H.R. REP. NO. 595, *supra* note 7, at 118, 428, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6079, 6383 (same).

95. *See supra* note 57 and accompanying text (most debtors may exempt all or nearly all property when filing in chapter 7).

96. *See* Shuchman & Rhorer, *supra* note 57, at 17, 20-23 (statistics show that debtors with low incomes have fewer and less valuable assets).

97. *See infra* text following note 189 (arguing that more restrictive exemptions in chapter 7 would attract more debtors to chapter 13).

98. *See infra* notes 104-12 and accompanying text (presenting credit industry proposal).

99. *See infra* text following note 189 (discussing alternative proposal).

amount that would be paid on such claim[s] if the estate . . . were liquidated under chapter 7."[100] Section 522, by permitting excessive exemptions in chapter 7, reduces the amount of debt that would be repaid under chapter 7 and, correspondingly, reduces the amount of debt that must be paid under chapter 13.[101] Conversely, moderate exemptions would result in higher payment levels.

3. Summary

Because section 522 contains loopholes in its exemption scheme and incorporates state exemption laws—some of which are excessive in a bankruptcy context—many debtors are able to discharge large amounts of debt while retaining large amounts of assets. If the exemption laws in bankruptcy were more moderate, debtors would stand to lose more property by filing under chapter 7. This would cause many debtors either to file under chapter 13 instead or to file no bankruptcy petition at all. In either case, debtors would pay larger amounts on unsecured claims than they are currently paying.

III. REFORM PROPOSALS

Both the consumer credit industry and the National Bankruptcy Conference have presented proposals to Congress for amending the bankruptcy laws. Of the two, the consumer credit industry's proposal has received more attention and has been more aggressively lobbied. Although the membership of the consumer credit industry and their consultants support this proposal, it has been disapproved by almost every impartial expert, including the National Bankruptcy Conference[102] and the National Conference of Bankruptcy Judges.[103] This section first criticizes the consumer credit industry's proposal on grounds of both policy and practicality. The section then addresses the National Bankruptcy Conference's proposal, arguing that it would fail to accomplish its goal and, in fact, would be largely counterproductive.

A. THE CREDIT INDUSTRY PROPOSAL

The credit industry proposal[104] is founded on the notion of "affordable debt." This proposal would deny the traditional chapter 7 relief of discharge of debt to a debtor if he "can pay a reasonable portion of his debts out of anticipated future income"[105] within, at most, a period of five years.[106] The

100. 11 U.S.C. § 1325(a)(4) (Supp. V 1981).

101. Because the minimum that creditors are entitled to receive in chapter 13 is whatever they would receive in chapter 7, chapter 13 plans make little or no payments to creditors when the debtor would be able to exempt much of his property in chapter 7 liquidations. *See* REFORM HEARINGS, pt. 1, *supra* note 2, at 279 (Report of the Attorney General) (chapter 7 exemptions have increased number of chapter 13 cases in which little or no payment is made); *cf.* REFORM HEARINGS, pt. 2, *supra* note 4, at 223-25 (noting increases in number of cases under new provisions of chapter 13 in which repayment to unsecured creditors is five percent or less).

102. *See Reform Hearings*, pt. 2, *supra* note 4, at 74.

103. *Id.* at 144.

104. The consumer credit industry proposal was introduced by Senator Dole as the Bankruptcy Improvements Act of 1981, S. 2000, 97th Cong., 1st Sess., 127 CONG. REC. S15673 (daily ed. Dec. 16, 1981) [hereinafter S. 2000].

105. *Id.* § 2(c) (proposing amendment to 11 U.S.C. § 109 (Supp. V 1981)).

106. *Id.* § 17(c) (proposing amendment to 11 U.S.C. § 1322(c) (Supp. V 1981)).

proposal defines the phrase "a reasonable portion of his debts" to mean "a substantial percentage of the total outstanding debt reflected upon the schedule of liabilities," excluding debts secured by a first mortgage or deed of trust on the debtor's principal residence.[107] "Anticipated future income" is defined to mean "such income . . . that the debtor has a reasonable expectation of receiving . . . and which is not needed by the debtor for the support of himself and his dependents."[108] Traditional chapter 7 discharge, however, would remain available if this repayment requirement "would impose undue hardship to a debtor."[109] The proposal would expand chapter 13's good faith requirement[110] to require additionally that "the plan represents a bona fide effort which is consistent with the debtor's ability to repay his debts, after providing support for himself and his dependents."[111] The plan either would have to last for five years or would have to provide for payment of a "reasonable portion" of all allowed, unsecured claims.[112]

The credit industry's proposal includes two other important amendments. The first amendment would delete the more generous discharge now granted by chapter 13,[113] making discharges under chapter 13 and chapter 7 identical.[114] The second amendment would deny debtors the option of selecting the federal exemptions in section 522(d).[115] As a practical matter, this amendment only would affect debtors in the sixteen states that have not already acted to deny debtors the right to select section 522(d).[116]

A major problem with the credit industry's proposal is that it is impracticable. Unlike the current law, under which the bankruptcy courts apply the objective criteria of section 1325(a),[117] the proposal calls upon the bankruptcy

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107. *Id.* § 2(c) (proposing amendment to 11 U.S.C. § 109 (Supp. V 1981)).
108. *Id.*
109. *Id.*
110. 11 U.S.C. § 1325(a)(3) (Supp. V 1981).
111. S. 2000, *supra* note 104, § 18(a) (proposing amendment to 11 U.S.C. § 1325(a) (Supp. V 1981)).
112. *Id.* § 18(d) (proposing amendment to 11 U.S.C. § 1325(a) (Supp. V 1981)).
113. 11 U.S.C. § 1328(a) (Supp. V 1981); *see supra* note 64 (comparing what debts may be discharged under chapter 7 and chapter 13).
114. S. 2000, *supra* note 104, § 19(a) (proposing amendment to 11 U.S.C. 1328(a) (Supp. V 1981)).
115. *Id.* § 7(a), (b) (proposing amendment to 11 U.S.C. § 522 (b), (d) (Supp. V 1981)).
116. *See supra* notes 16 and 32-36 and accompanying text (discussing section 522(b)'s provision that debtors may choose between federal and state exemptions, but that states may deny their residents the right to select federal exemptions).
117. 11 U.S.C. § 1325(a) (Supp. V 1981). Section 1325(a) provides that:

> (a) The court shall confirm a plan if—
> (1) The plan complies with the provisions of this chapter and with other applicable provisions of this title;
> (2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;
> (3) the plan has been proposed in good faith and not by any means forbidden by law;
> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;
> (5) with respect to each allowed secured claim provided for by the plan—
> (A) the holder of such claim has accepted the plan;
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> (C) the debtor surrenders the property securing such claim to such holder; and

courts to apply five subjective and vague standards to determine "affordable debt." When determining whether a plan should be confirmed, how will a bankruptcy judge decide what is "a reasonable portion" of unsecured claims?[118] What is a "substantial percentage of the total outstanding debt"?[119] At what point does requiring repayment "impose undue hardship" on the debtor or his dependents?[120]

The application of the two parts of the "anticipated future income" definition would be equally impracticable. The first part of the definition requires determining what income the debtor has a reasonable expectation of receiving.[121] As Professor Countryman has pointed out, not even the credit industry's economist would venture to project debtors' future incomes for a two-year period,[122] not to mention the five-year period for which most plans would run.[123] Because many persons seek bankruptcy relief because of irregular employment,[124] such projections could be expected to be highly speculative and unreliable[125] and to vary considerably from one bankruptcy judge to

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(6) the debtor will be able to make all payments under the plan and to comply with the plan.

Id.

118. *See supra* note 105 and accompanying text. No guidance at all is offered regarding the meaning of this vague phrase. *See Reform Hearings*, pt. 2, *supra* note 4, at 130 (statement of Ellen Broadman, spokesperson for Consumers Union) (definition left to "whims of individual bankruptcy judges"); *id.* at 152 (statement of Judge Gandy, President of National Conference of Bankruptcy Judges) (definition "highly speculative"). *But cf. id.* at 163 (letter of Judge Mabey) (although initially different standards might arise in different parts of country, definition would become settled after "shakedown period").

119. *See supra* note 107 and accompanying text.

120. *See supra* note 109 and accompanying text. The current bankruptcy law already embodies an undue hardship standard, the interpretation of which is instructive in anticipating problems that might arise in applying the credit industry's proposed undue hardship standard in chapter 7. Under section 523(a)(8), educational loans may be discharged only if refusal to discharge the loan would "impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. § 523(a)(8)(B) (Supp. V 1981). Applying the standard has not been difficult in some cases. *See, e.g., In re* Bell, 5 Bankr. 461, 463 (Bankr. N.D. Ga. 1980) (court found no hardship because defendant was permanently employed in job for which trained); *In re* Diaz, 5 Bankr. 253, 254 (Bankr. N.D.N.Y. 1980) (court found hardship because debtor had significant medical expenses and four children and was unable to work due to illness). In other cases, however, applying the standard has been troublesome. *See, e.g., In re* Andrews, 661 F.2d 702, 705 (8th Cir. 1981) (hardship standard difficult to apply when effect of debtor's illness on ability to repay loan depends on many factors, including scope of health insurance); *In re* Kammerud, 15 Bankr. 1, 9 (Bankr. S.D. Ohio 1980) (mechanical test for undue hardship considers many factors, including debtor's employment status, future employment and income prospects, skills and educational level, and any other factors which relate to performance in these areas, such as health, marketability of skills, and responsibility for small dependent children); *In re* Rice, 13 Bankr. 614, 616-17 (Bankr. D.S.D. 1981) (court required showing of good faith before discharge could be granted); *In re* Conrad, 6 Bankr. 151, 153 (Bankr. W.D. Ky. 1980) (claim of undue hardship rejected because unclear whether debtor supported elderly parent and because debtor failed to make adequate search for job). In addition to illustrating the difficulties of applying a vague, subjective standard, these cases indicate that subjective standards generate more litigation and extra costs.

121. *See supra* note 108 and accompanying text (quoting definition of "anticipated future income").

122. *Reform Hearings*, pt. 2, *supra* note 4, at 75 (statement of Prof. Countryman, Harvard Law School).

123. *See supra* note 112 and accompanying text.

124. *See Reform Hearings*, pt. 1, *supra* note 2, at 18 (statement of Andrew Brimmer, credit industry consultant) (loss of employment a factor in 39.3% of bankruptcies).

125. *See Reform Hearings*, pt. 1, *supra* note 2, at 61 (statement of Claude Rice, Alvin Wiese, Jr., and Jonathan Landers, credit industry consultants) (any provision requiring judge to determine how much of debtor's consumer contractual debts each debtor could pay would impose tremendous burden on courts); *Reform Hearings*, pt. 2, *supra* note 4, at 75 (statement of Prof. Countryman) (bankruptcy judges cannot forecast debtors' future incomes and expenses).

another.[126]

The second part of the "anticipated future income" definition—income that is "needed by the debtor for the support of himself and his dependents"[127]—also presents difficulties of application and raises basic policy questions. In attempting to apply the standard, bankruptcy judges not only would be making highly speculative projections, but also would be imposing their own values on debtors' families.[128] Judge Gandy illustrated this point in his testimony at the recent Senate hearings on further bankruptcy reform:

> This would require . . . the bankruptcy judge to establish the reasonable norm of society in reference to expenses.
>
> What is the reasonable norm in reference to transportation, say? I am a fanatic on the energy crisis . . . . Does that mean that all bankrupts would have to drive low-priced cars, or would they have to take the bus? This is a very difficult problem.[129]

Similarly, difficult judgments would have to be made about numerous other expense items in different family contexts. The difficulties in making these judgments make the proposal unworkable; the likely variation in the judges' decisions makes the proposal inequitable; and the imposition of the judges' various values on debtors' families makes the proposal unpalatable.

Because the various projections are so indefinite, modifications of plans are likely to be common.[130] Changed circumstances such as unemployment, family illness, new children, inflation, parental support, and rent increases will require plan modifications, which will present burdens for debtors, creditors, and courts. The credit industry's proposal also will greatly increase the costs of bankruptcy in general. Unlike the present law, which provides virtually no criteria for chapter 7 and only objective criteria for chapter 13,[131] the proposal

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126. Bankruptcy Judge Mabey acknowledges that different standards of reasonableness would develop in different regions of the country, but he nevertheless supports the industry's proposal to anticipate a debtor's future income. *Reform Hearings*, pt. 2, *supra* note 4, at 163 (letter from Judge Mabey); *cf. id.* at 221 (statement of Paul Tongue, representative of bank associations) (arguing that different judges apply different standards when evaluating percentage return plans for chapter 13 creditors).

127. *See supra* note 108 and accompanying text (quoting definition of "anticipated future income").

128. Many critics of the proposal addressed this point. *See Reform Hearings*, pt. 1, *supra* note 2, at 300 (statement of Richard Levin, Director and Counsel, Executive Office for U.S. Trustees, Department of Justice) (noting delicate problem of bankruptcy judge imposing his judgment about debtor's standard of living); *Reform Hearings*, pt. 2, *supra* note 4, at 72-73 (statement of Ellen Broadman, spokesperson for Consumers Union) (suggesting that courts may allow different living expenses for debtors of different economic levels); *id.* at 169 (statement of Judge Lee) (suggesting that courts may make value judgments concerning debtors' lifestyles).

129. *Reform Hearings*, pt. 2, *supra* note 4, at 145 (statement of Judge Gandy); *see also* LoPucki, *supra* note 9, at 370-72 (bankruptcy judges may have to determine how well debtor may eat and dress and where he may live).

130. Senator Heflin stated the problem nicely: "I can foresee that every time . . . [a] man has . . . to go to the doctor causing an increase in his costs, he has got to come back [to court] and petition [for a plan modification] because of a doctor bill . . . ." *Reform Hearings*, pt. 2, *supra* note 4, at 16; *accord id.* at 71 (statement of Prof. Shuchman, Rutgers School of Law) (providing judicial hearings for plan modifications increases bankruptcy courts' costs); *id.* at 75 (statement of Prof. Countryman) (difficult for bankruptcy courts to forecast future income and expenses of debtors).

131. Some courts have applied a subjective criterion by interpreting section 1325's "good faith" provision to require substantial payments on unsecured debt. *See supra* notes 58-60 and accompanying text.

will require litigation of the various subjective and vague standards discussed above. This will further increase debtors' and creditors' costs as well as impose significant new burdens and costs on the bankruptcy courts.[132]

Even if the proposal were workable and less costly, it represents bad policy. The credit industry and its consultants argue that the proposal is justified on the ground that consumer credit is different from commercial credit.[133] Industry consultants have explained that "[t]he basic assumption of the consumer credit industry is that consumers will pay debts out of future income rather than from the liquidation of existing assets."[134] Accordingly, they argue that chapter 7 liquidation, with its liberal discharge provision, is inappropriate in the consumer context.[135] An industry consultant has even analogized consumer debt to federal student loan debt, presumably on the theory that both are expected to be repaid from future earnings.[136]

The credit industry's arguments are fallacious. First, the very large amount of *secured* consumer debt[137] belies the industry's thesis that the industry is looking to income and not assets as the source of debt satisfaction. The industry's attack[138] on section 522(f)(2)—which voids certain nonpurchase money *security interests* in consumer goods[139]—likewise contradicts its assumption about the source of consumer debt repayment. Second, the analogy to federal student loan debt is a feigned attempt to conform the industry's proposal to accepted policy that denies discharge of student loans except in hardship situa-

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132. Most witnesses emphasized that the credit industry proposal would increase burdens and costs on bankruptcy courts. *See Reform Hearings*, pt. 2, *supra* note 4, at 70-72 (statement of Prof. Shuchman) (proposal could generate significant increase in litigation resulting in impossible burden for bankruptcy judges); *id.* at 119 (statement of Prof. Shuchman and Thomas Rhorer) (proposal would greatly increase debtors' expenses); *id.* at 151 (statement of Judge Gandy) (proposal would require extensive trials of highly complicated matters); *id.* at 167 (statement of Judge Lee) (proposal would cause enormous cost and waste of judicial manpower). Judge Lee questioned whether taxpayers should bear the "substantial additional cost of administration inherent in [the credit industry's] . . . proposed change in the bankruptcy system." *Id.* at 184 (letter of Judge Lee). Other witnesses testified that the proposal would not be burdensome on the courts. *See Reform Hearings*, pt. 1, *supra* note 2, at 44 (statement of Claude Rice, consumer credit industry consultant) (proposal's requirement that creditors' approve debtor's application for relief will not burden courts); *cf. Reform Hearings*, pt. 2, *supra* note 4, at 163 (statement of Judge Mabey) (unforeseen legal issues will arise for interpretation by courts, but not insurmountable).

133. *Reform Hearings*, pt. 1, *supra* note 2, at 52 (statement of Claude Rice, Alvin Wiese, Jr., and Jonathan Landers).

134. *Id.*; *accord id.* at 10 (statement of Andrew Brimmer) (consumer credit industry looks to debtors' future income as security for loans).

135. *Id.* at 53 (statement of Claude Rice, Alvin Wiese, Jr., and Jonathan Landers).

136. *See id.* at 36, 37-38 (statement of Andrew Brimmer) (lenders extend credit to students based on anticipated future income, not present assets).

137. *See Reform Hearings*, pt. 2, *supra* note 4, at 126 (statement of Prof. Shuchman and Thomas Rhorer) (43% of consumer credit secured by cars and mobile homes).

138. *See* S. 2000, *supra* note 104, § 7(c) (proposing to delete provision that invalidates nonpurchase money security interests in specified categories of property when such property qualifies for exemption); *Reform Hearings*, pt. 1, *supra* note 2, at 23 (statement of Andrew Brimmer) (discussing bankruptcy law provisions that invalidate certain security interests); *id.* at 80-81 (statement of Claude Rice, Alvin Wiese, Jr., and Jonathan Landers) (arguing that essential fallacy of section 522(f)(2) is that section assumes need for liquidation, but then finds liquidation unacceptable and invalidates security interests to avoid liquidation).

139. 11 U.S.C. § 522(f)(2) (Supp. V 1981). A nonpurchase money security interest is a lien created by an agreement between a debtor and a creditor whereby the debtor offers collateral, other than the goods purchased, to secure repayment of the money or the credit advanced by the creditor. *See* U.C.C. § 1-201(37) (1972) (defining security interest); *id.* § 9-107 (defining purchase money security interest).

tions.[140] The analogy is stretched beyond tolerance, however, and the proposal must be viewed as the radical one that it is. Unlike consumer credit transactions, there is no evaluation of students' future earning potential in the federal student loan program. Art history and Buddhist philosophy majors qualify for loans as easily as computer science and engineering students.[141] Moreover, student loans, unlike consumer credit, are granted *inversely* to wealth and income: only the needy qualify.[142]

Third, the industry's assertion that "consumer credit is different" from other types of credit is simply inaccurate. When lending to both businesses and consumers, lenders expect that payments eventually will be generated by future earnings.[143] Although a lender does not expect the consumer or the business to default, it must contemplate that eventuality. In both the consumer and the business context, the lender may require collateral to protect against default, especially when the risk of default is relatively high.[144] If there is inadequate collateral or if laws prohibit security interests in certain types of collateral,[145] the lender may simply reject the business' or consumer's loan request. The consumer credit industry evidently has failed to follow this latter course,[146] doubtless believing that more risky overall loan portfolios produce more than

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140. 11 U.S.C. § 523(a)(8) (Supp. V 1981).

141. Higher Education Resources and Student Assistance Act, title IV, § 464, 20 U.S.C. § 1087dd(b) (Supp. V 1981) (federally-financed loan may be made to any student capable of maintaining good standing in course of study in institution of higher education).

142. *Id.* § 1087dd(b)(1) (federally-financed loans may be made to students enrolled in institutions of higher education who demonstrate need); *see Education Amendments of 1980*, H.R. REP. NO. 520, 96th Cong., 2d Sess. 40 (1979), *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 3141, 3180 (National Direct Student Loan program "insures that needy students can obtain loan assistance without being confronted with the difficulties that exist in obtaining loans under other educational loan programs").

143. *See generally* P. HUNT, C. WILLIAMS & G. DONALDSON, BASIC BUSINESS FINANCE 183-94 (rev. ed. 1961) (discussing return-on-investment calculation used to evaluate financing arrangements); *cf.* J. BOGEN, FINANCIAL HANDBOOK § 16.14 (4th ed. 1964) (noting that commercial loans are secured by accounts receivable); H. GUTHMAN & H. DOUGALL, CORPORATE FINANCIAL POLICY 449-51, 484-85 (4th ed. 1962) (discussing factors taken into account for commercial loans, including projections of future earnings and cash flow). By stating that "[b]usiness credit is granted, *at least in part*, against the liquidation value of existing assets," *Reform Hearings*, pt. 1, *supra* note 2, at 52 (statement of Claude Rice, Alvin Wiese, Jr. and Jonathon Landers) (emphasis added), the credit industry consultants implicitly acknowledge that business credit is extended in part in expectation of future earnings. This somewhat qualifies the consultants' claim that consumer credit is different from business credit because consumers are expected to repay loans out of future income instead of liquidation of assets. *See supra* notes 133-34 and accompanying text.

144. A. SCHWARTZ & R. SCOTT, COMMERCIAL TRANSACTIONS 507-10 (1982).

145. Laws prohibiting security interests in certain types of collateral often are based on sound policy grounds. *Cf.* H.R. REP. NO. 595, *supra* note 7, at 127, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6088 (prohibiting security interest in household goods is good policy because goods have little resale value and are more valuable in debtors' hands).

146. Bankruptcy Judge George has stated that: "[W]e cannot overlook the extent to which those who now complain of the new bankruptcy law have themselves . . . precipitated, to some extent, the current crisis by reckless disregard for safe credit and lending practices." *Reform Hearings*, pt. 1, *supra* note 2, at 204 (statement of Judge George). *See also Reform Hearings*, pt. 2, *supra* note 4, at 129, 133-34 (statement of Ellen Broadman) (lenders' reliance on individuals' long-term earnings for debt repayment encourages aggressive credit extension to those who cannot meet payments); *id.* at 146 (statement of Judge Lee) (current over-extension of credit is result of "improvident loans"); *cf. id.* at 167-68 (statement of Judge Lee) (noting that there has been glut of consumer credit over last 12 years and relative decrease in number of consumer bankruptcies). *But see id.* at 202 (statement of Raymond Kennedy, representative of retail merchants associations) (less cost for credit grantor in today's approach with credit cards, but not at lower standards for establishing credit); *id.* at 216-18 (statement of Paul Tongue) (granting credit on basis of future income not discouraged by increased number of bankruptcy filings because significant portion of those who file have substantial ability to repay debts).

commensurate net returns. Now the industry seeks to amend the fundamental structure of the Bankruptcy Act to provide insurance against their losses.

The foregoing analysis shows that the rationale behind the industry's proposal is deficient. Even if the rationale were meritorious, the impracticability of the proposal and the severe impact it would have on debtors and their families militate against adoption of the proposal.[147]

Furthermore, there are curious policy inconsistencies in the proposal itself. The proposal might operate to reward debtors who have been able to amass so much debt that they would be unable to pay "a substantial percentage" of their total debt. Such debtors would qualify for chapter 7 without being forced into chapter 13, while more responsible debtors would be denied chapter 7 relief. Not only is this perverse, but it would inject undesirable incentives into the bankruptcy system and the consumer credit market. Moreover, the proposal might encourage debtors to alter their employment patterns in anticipation of bankruptcy[148] so that the projection of future income would be lower; in this way they might either qualify for chapter 7[149] or only be required to propose plans calling for low repayments.[150]

In summary, the credit industry's main proposal is not supported by sound reasoning. The proposal is defective practically because of the numerous vague and subjective standards it would inject into a bankruptcy system that now contains workable, generally clear, objective standards. These new standards would increase costs to already embarrassed debtors, to creditors, and to the bankruptcy court system. A less costly, wiser cure for the consumer credit industry's ills would be to adopt more prudent credit-granting policies.

The credit industry's other two major proposals are to delete the section 522(d) exemption option from the Act[151] and to conform chapter 13's current liberal discharge to the narrower chapter 7 discharge.[152] For reasons that have been discussed above[153] and will be discussed further below,[154] the latter proposal is sound. The deletion of section 522(d)'s exemptions, however, is unsound and, in fact, is not in the credit industry's best interests. Section 522(d)'s option, in the sixteen states that allow their debtors to elect it, has probably had very little adverse effect on creditors.[155] Much more harm has been caused by section 522(b)'s incorporation of state exemptions into the otherwise uni-

147. *Cf. Reform Hearings*, pt. 2, *supra* note 4, at 141-42 (statement of Prof. Countryman) (discussing reasons for rejection of similar proposals in past).

148. *Id.* at 75 (proposal would create incentive for debtor to quit working in order to qualify for chapter 7).

149. *See supra* note 109 and accompanying text (under proposal, debtor could qualify for chapter 7 discharge if denial would impose undue hardship).

150. *See supra* note 111 and accompanying text (proposal would expand chapter 13's good faith provision to require debtor to make bona fide effort to repay debts).

151. S. 2000, *supra* note 104, § 7(a), (b) (proposing amendment to 11 U.S.C. § 522(b), (d) (Supp. V 1981)).

152. *Id.* § 19(a) (proposing amendment to 11 U.S.C. § 1328 (Supp. V 1981)).

153. *See supra* notes 63-73 and accompanying text (demonstrating how chapter 13's broader discharge provisions actually encourage minimal repayment).

154. *See infra* notes 182-85 and accompanying text (criticizing chapter 13's broad discharge provisions).

155. *See* Shuchman & Rhorer, *supra* note 57, at 3, 6-9, 22 (section 522(d) had little impact in cases studied on unsecured creditors).

form Act.[156] A more sensible and equitable solution would be either to make a slightly modified section 522(d) the exclusive exemption scheme in bankruptcy[157] or, what may be a politically necessary alternative, to enact a maximum dollar value limitation on debtor exemptions.[158]

B. THE NATIONAL BANKRUPTCY CONFERENCE PROPOSAL

The National Bankruptcy Conference (NBC)[159] opposes the consumer credit industry's proposal to make chapter 7 unavailable to debtors who can pay a substantial percentage of their debt.[160] The NBC has presented an alternative proposal that is directed solely at chapter 13.[161] Its proposal would add an "ability-to-pay" test to section 1325.[162] This test would enable unsecured creditors to object to a chapter 13 plan that proposed to pay less than one hundred percent of unsecured claims.[163] A creditor could not object to a plan if the proposed payments equalled the debtor's "total projected disposable income" for the three-year period after payments began.[164] Determination of a debtor's "total projected disposable income" would be made "in light of his primary duty to support himself and his dependents during the three-year period."[165] Creditors would have the burden of establishing that a proposed plan did not meet this new test.[166] The debtor or creditors could request modifications of the payment plan if there were a change in circumstances that affected the debtor's disposable income.[167] The NBC does not propose changes in chapter 13's broad discharge provision or in the debtor's right to convert the case to chapter 7.[168]

The NBC advanced its proposal to "dispel most of the criticism of present chapter 13."[169] The NBC points to "the debtor's right (or privilege) to the more generous relief of chapter 13."[170] The NBC believes that adoption of its proposal would preserve the debtor relief provisions that are designed to encourage wider use of chapter 13.[171]

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156. For example, state laws, not section 522(d), allow for the exemption of the following: millions of dollars of property, *see supra* notes 75 and 79 and accompanying text; homesteads worth $45,000 or $80,000, *see supra* notes 88-89 and accompanying text; and large amounts of cash, *see In re* Hall, 13 Bankr. 918, 923 (Bankr. D. Hawaii 1981) ($30,000 cash exempt); *In re* Haddad, 15 Bankr. 903, 906 (Bankr. App. 9th Cir. 1981) (over $30,000 in life insurance proceeds exempt).

157. *See infra* notes 195-97 and accompanying text.

158. *See infra* note 199 and accompanying text.

159. Technically, the proposal is presented by two committees of the National Bankruptcy Conference: the Consumer Bankruptcy Committee and the Chapter 13 Committee. *See Reform Hearings*, pt. 1, *supra* note 2, at 192 (statement of Prof. King, New York University School of Law and representative of NBC).

160. *Id.* at 186-87.

161. *Id.* at 196.

162. *Id.* at 194-95.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.* at 195.

167. *Id.* (request may be made at any time within three years of plan); *see id.* at 188 (arguing that debtor and creditor should be able to seek modification of plan); *see also infra* note 181.

168. *Reform Hearings*, pt. 1, *supra* note 2, at 195-96 (statement of Prof. King).

169. *Id.* at 196.

170. *Id.* at 195.

171. *Id.* at 196.

The NBC's proposal has two major shortcomings. First, it is counterproductive because it would discourage chapter 13 use. Debtors who might file for chapter 13, but who have significant disposable income, would be diverted to chapter 7. Moreover, no debtors who now file in chapter 7 would be induced to file in chapter 13.

Consider the NBC proposal in reference to two major incentives for filing under chapter 13. One incentive is that chapter 13 provides more liberal discharge of debt than does chapter 7.[172] Although the NBC considers the liberal discharge provision to be the major incentive to file under chapter 13,[173] its ability-to-pay test in practice would reduce this incentive. If debtors have nondischargeable debt under chapter 7 that is less than their projected disposable income, they ultimately would surrender less to creditors by filing under chapter 7 than under chapter 13. Accordingly, under the NBC's proposal, chapter 13's broader discharge provision would lose some of its strength as an incentive.

Another incentive to file under chapter 13 is that debtors may retain assets that are nonexempt under chapter 7.[174] The NBC proposal in no way enhances this incentive, however, and in fact might divert debtors with nonexempt assets to chapter 7 if the value of their nonexempt assets is less than the value of their "total projected disposable income."[175] Consequently, the NBC proposal would operate to attenuate the existing incentives to file under chapter 13.

An even more important consequence of the NBC proposal is that it would discourage the majority of debtors who now file in chapter 13, not because of its incentives, but because they want to repay some of their debt. If their "total projected disposable income" is more than they are willing to repay, they would file under chapter 7. Because the NBC proposal presents these debtors with the formidable risk that a court might find their "total projected disposable income" to be significantly greater than the debtors believe it to be, the likely tendency would be to file in chapter 7.

A separate issue is whether the proposal will increase total payments to creditors holding unsecured claims, apparently a further goal of the NBC. When testifying for the NBC, Professor King stated that:

> In order to be entitled to that incentive—to that broader discharge [of debt in chapter 13]—it is [the NBC's] feeling [that] . . . the debtor should have to pay for it. That is, the debtor should have to pay more for the chapter 13 use than for the chapter 7 use.[176]

Currently, chapter 13's broader discharge in fact discourages payments on unsecured claims in excess of what would be paid under chapter 7.[177] The NBC proposal probably would increase payments by debtors who seek the broader

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172. 11 U.S.C. § 1328(a) (Supp. V 1981); *see supra* note 64 and accompanying text (comparing what debts may be discharged under chapter 7 and chapter 13).

173. *See Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King).

174. 11 U.S.C. § 1306(b) (Supp. V 1981). Section 1306(b) provides that "[e]xcept as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate." *Id.*

175. *See supra* notes 162-65 and accompanying text (discussing ability-to-pay test).

176. *Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King).

177. *See supra* notes 61-73 and accompanying text.

chapter 13 discharge. The net effect of the proposal on all chapter 13 cases, however, probably would be to decrease payments on unsecured claims. Although there is no empirical evidence on this point, it is unlikely that a large percentage of debtors file chapter 13 petitions because they have nondischargeable chapter 7 debt, excluding family support obligations. Moreover, if the NBC proposal were adopted, some debtors with nondischargeable debt would not file in chapter 13, but rather in chapter 7.[178] Perhaps most importantly, the proposal would decrease significantly total chapter 13 payments to the extent that it discourages chapter 13 filings by the many debtors who might have paid more than the minimally required amounts but who would not pay the greater amounts required by the ability-to-pay test.[179]

In addition to being counterproductive, the NBC proposal has two other drawbacks. The first is basically similar to the criticism of the consumer credit industry proposal. Debtors, creditors, and bankruptcy courts will spend money and time trying to apply the vague and subjective ability-to-pay test, which requires a case-by-case determination of a debtor's total projected disposable income.[180] Moreover, like the credit industry proposal, the NBC proposal would permit modifications of payment plans due to changed circumstances, thereby increasing litigation costs.[181]

The second shortcoming is that the proposal assumes that having a broader discharge in chapter 13 than in chapter 7 is a sound policy. Little can be said, however, in support of this policy if one accepts the soundness of the policy that denies discharges of section 523 debts in chapter 7.[182] The broader chapter 13 discharge was an innovation of the Bankruptcy Reform Act of 1978 and was envisioned as a device to encourage greater use of chapter 13.[183] The policy implications of this innovation were never discussed or analyzed. In effect, the broader discharge sacrifices the claims of special creditors for what was believed to be the good of all creditors with unsecured claims. The creditors whose claims are sacrificed are generally individuals who unwittingly have become creditors when a debtor's guile or other antisocial behavior[184] has caused them a loss. Under the current law, this sacrifice is for naught since the goal of chapter 13's broader discharge has not been realized.[185] The NBC proposal

178. *See supra* text following note 172.

179. *See supra* text following note 175.

180. *See supra* notes 117-32 and accompanying text (criticizing consumer credit industry "affordable debt" proposal on ground of impracticability).

181. *See supra* note 167 and accompanying text (discussing opportunity to modify plan under NBC proposal). In his testimony before the Senate, Professor King explained that "it would be up to the court to decide on the basis of the evidence presented to it whether the plan should be modified." *Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King). For a criticism of the modification option, see *supra* note 130 and accompanying text.

182. It is beyond the scope of this article to analyze the discharge provision of chapter 7. Although the discharge provision has its shortcomings, it does represent a congressional judgment that chapter 7 nondischargeable debts are special and deserve, to some extent, more favorable treatment than other claims. *See also infra* note 185 (discussing some bankruptcy judges' criticisms of chapter 13's broader discharge of debt).

183. *See Reform Hearings*, pt. 1, *supra* note 2, at 188 (statement of Prof. King) (chapter 13 enacted to provide incentive to debtors to pay debts voluntarily to extent possible).

184. 11 U.S.C. § 523(a)(2), (4) (Supp. V 1981) (discharging liabilities for fraud and willful and malicious injuries).

185. *See supra* notes 61-67 and accompanying text (discussing failure of chapter 13 to achieve more substantial debt repayment). Some courts, troubled by the broader chapter 13 discharge, have used the

would result in some greater return for other creditors with unsecured claims in cases of debtors who have disposable income; however, the game is not worth the candle.

The source of the NBC proposal's major shortcoming is that debtors, confronted with the prospect of paying creditors a part of their income over the next three years under chapter 13, can simply turn to chapter 7 if repayment is undesirable.[186] The consumer credit industry correctly perceives that the easy availability of chapter 7 is an insurmountable barrier to the goal of encouraging large repayment plans under chapter 13. The credit industry's radical proposal, however, would create minor chaos in the bankruptcy courts[187] and is antithetical to social norms about and experience with the use of compulsion to realize debt repayment.[188]

IV. AN ALTERNATIVE APPROACH

To overcome the major criticisms of the new Bankruptcy Act, one simple and relatively minor change is needed. The exemption policy should be modified by reducing bankruptcy exemptions.[189] Reducing exemptions would have major benefits. First, the number of bankruptcy filings should decline because reducing exemptions would make bankruptcy more costly. Some debtors who now can file in chapter 7, obtaining a discharge and retaining all or most of their assets under the current exemption policy, would not file if they had to surrender some valued assets. These debtors instead will resolve their financial problems outside of bankruptcy, thereby increasing the level of debt repayment. Second, egregious cases, in which large amounts of debt are discharged while debtors retain significant wealth,[190] would be eliminated. Third, and affecting many cases, debtors with nonexempt assets would have a stronger incentive to file in chapter 13, which permits debtors to retain all their property.[191] Fourth, this approach would result in larger payments in chapter 13 to creditors with unsecured claims. This follows because chapter 13 debtors must pay "on account of each allowed unsecured claim . . . the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7"[192] and because a reduction in exemptions would increase the amounts distributed in chapter 7 liquidations. Incidentally, the group of debtors who

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"good faith" provision to require substantial payments in cases in which chapter 7 dischargeable debt is involved. *See supra* note 44 and accompanying text. More generally, a few bankruptcy judges have expressed their displeasure with the broad chapter 13 discharge. *See In re* Pike, 14 Bankr. 241, 242, 243 & n.5 (Bankr. W.D. Ky. 1981) (expressing "distaste at being ineluctably led by a clear statute to a wrong result"); *In re* Tackaberry, 13 Bankr. 881, 882 (Bankr. D. Minn. 1981) (noting incongruity of certain debt being dischargeable under chapter 13 but not chapter 7).

186. *Reform Hearings*, pt. 1, *supra* note 2, at 194 (statement of Prof. King).

187. *Reform Hearings*, pt. 2, *supra* note 4, at 144 (statement of Judge Gandy, President of National Conference of Bankruptcy Judges) (credit industry proposal would generate litigation "that would wreck the system"); *cf. supra* note 125 (requiring bankruptcy judges to determine how much each debtor can repay would impose tremendous burden on courts).

188. *See generally Reform Hearings*, pt. 2, *supra* note 4, at 141-42 (statement of Prof. Countryman) (credit industry proposal "contrary to the genius of our institutions" because it resurrects values inherent in peonage and imprisonment for debt).

189. *See supra* notes 78-92 and *infra* notes 195-202 and accompanying text.

190. *See supra* notes 22-23 and accompanying text.

191. 11 U.S.C. § 1306(b) (Supp. V 1981); *see supra* note 174 (quoting text of section 1306(b)).

192. 11 U.S.C. § 1325(a)(4) (Supp. V 1981).

would be affected by reducing exemptions roughly corresponds to the group of debtors who have "affordable debt" and "disposable income" and accordingly would be encompassed by the credit industry's and National Bankruptcy Conference's proposals. Some statistical evidence supports the proposition that debtors who have acquired greater assets are likely to have larger incomes.[193] This correlation is also intuitive.

This approach would directly resolve the major criticisms of the new law while preserving its fundamental and traditional character. The bankruptcy rate would be curtailed, egregious cases that cast a shadow on the integrity of the bankruptcy system would be eliminated, and more debtors would repay more debts through chapter 13. Moreover, this approach does not create any new, subjective, vague, or intrusive standards as the other proposals do. The courts would continue to apply objective standards by evaluating the market value of assets and applying the exemption provision. Finally, this approach would not increase costs to the parties and burdens on the courts. There may be more chapter 13 cases to supervise, but that is presumably an acceptable cost.

In order to realize the Bankruptcy Reform Act's goal of encouraging more debtors to make more substantial repayment plans under chapter 13, Congress must make chapter 7 less attractive to debtors. The effectiveness of chapter 13 largely depends on section 522's exemption policy as it applies in chapter 7. Unless Congress is willing to alter the fundamental character of the bankruptcy process,[194] amending section 522 is the only effective means of achieving the goal of more substantial debt repayment.

First, state exemptions should not be available to debtors. As discussed above, state exemptions serve a different function than bankruptcy exemptions.[195] Only Congress should be able to decide what amount of property debtors who enjoy the benefits of bankruptcy should be allowed to retain. The possibilities for abusing the exemptions[196] do not involve the election of the federal exemptions under section 522(d) but rather the election of state exemptions under section 522(b).[197] If Congress made section 522(d) the sole exemption, with some slight modification as suggested below, no one could complain that Congress was "too rough on debtors." At the same time, Congress would not be too easy on debtors and the integrity of the bankruptcy process would be restored.

Because evidently there was some mystical virtue in incorporating state exemption laws into the Bankruptcy Act,[198] it may be politically unacceptable to

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193. *See Reform Hearings*, pt. 1, *supra* note 2, at 28 (statement of Andrew Brimmer) (very high income persons who have debts larger than their income also may have very large assets); Shuchman & Rhorer, *supra* note 57, at 17 (as income rises, value of assets as well as unsecured debt rises).

194. The credit industry's current proposal is impracticable. *See supra* notes 117-32 and accompanying text (criticizing proposal). Any fundamental change must be studied and discussed more carefully and thoroughly to insure its practicability.

195. *See supra* notes 86-92 and accompanying text (discussing bad policy of allowing debtors to elect state exemptions).

196. *See supra* notes 22-23 and accompanying text.

197. *See supra* notes 79, 85, 156 and accompanying text (criticizing debtor's right to choose state exemptions because selection leads to excessive exemptions).

198. Virtually everyone who has studied the issue has recommended against permitting the incorporation. Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 680 (1960)

remove the state law option from the exemption provision. Even if retaining state exemptions is a political necessity, however, Congress could still set a maximum dollar limitation on the assets exempted under state law and retain some of the benefits of this approach. For example, a limitation of $7,000 would appear equitable.

Second, the $7,500 homestead exemption in section 522(d)(1)[199] should be eliminated. Elimination of the $7,500 exemption might seem harsh to some who value home ownership as an important American tradition. Yet, this proposal is neither harsh nor contrary to that tradition. Few debtors who find themselves in bankruptcy own homes.[200] Moreover, debtors who do have an equity interest in their homes may preserve it by filing chapter 13 petitions and thereby retaining all their property. It is not unfair to require these debtors to pay part of their debt as a condition of retaining their homes. After all, these debtors most likely have been paying their housing debt while ignoring the debt owed to other creditors.[201]

To compensate for losing the homestead exemption, the "any property" exemption in section 522(d)(5)[202] should be increased from $400 to $3,000. This provision allows debtors to protect otherwise nonexempt belongings that might have special importance to family members as well as a modest amount of cash for food, rent, and other essentials. The proposed increase in section 522(d)(5) is really no increase at all because it is currently included in whatever part of the $7,500 homestead exemption that is not used up in the value of the homestead.[203] Accordingly, this approach effectively would result in a net decrease in allowable exemptions of $4,900.[204] In any case, it is desirable to allow debtors to protect assets that might not be listed in section 522(d) or that are listed but exceed the dollar value limitation because items such as family heirlooms, musical instruments, and gifts may have special value to family mem-

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(stressing necessity of having clearly defined federal bankruptcy exemption policy rather than one which incorporates exemption laws of states); King, *Proposed Amendments to the Chandler Act*, 45 COM. L.J. 36, 40 (1940) (advocating that Congress prescribe uniform exemptions because bankruptcy no longer local in character); Vukowich, *The Bankruptcy Commission's Proposals Regarding Bankrupts' Exemption Rights*, 63 CALIF. L. REV. 1439, 1441 (1975) (arguing that incorporation of state exemptions leads to inconsistent bankruptcy policy and unequal treatment of debtors); Note, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 667 (1968) (arguing that growth of national credit and emergence of mobile society require uniform exemption policy).

199. 11 U.S.C. § 522(d)(1) (Supp. V 1981). This provision exempts "[t]he debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence . . . ." *Id.*

200. Shuchman & Rhorer, *supra* note 57, at 7 (only 22 of 461, or 4.8%, of debtors studied had significant equity in real estate); *see* COMM'N ON THE BANKRUPTCY LAWS REPORT, *supra* note 91, at 43-44 (only small percentage of debtors in bankruptcy were purchasing homes); *cf.* NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 21 (1972) (homeowner-debtors less likely to have credit trouble than other debtors).

201. Debtors are generally more current on secured debts than on unsecured debts because secured creditors have leverage that unsecured creditors do not have: the threat of foreclosure or repossession.

202. 11 U.S.C. § 522(d)(5) (Supp. V 1981). This subsection exempts "[t]he debtor's aggregate interest, not to exceed in value $400 plus any unused amount of the exemption provided under . . . [section 522(d)(1) ($7,500 homestead exemption)], in any property." *Id.*

203. *See id.*

204. Under the current law, a debtor may exempt up to $7,500 for his homestead, *id.* § 522(d)(1), and up to $400 in "any property," *id.* § 522(d)(5), for a total of $7,900. This proposal removes the $7,500 homestead exemption and substitutes a $3,000 exemption for "any property."

bers. The $3,000 amount is admittedly somewhat arbitrary but seems fair given the other exemptions in section 522(d).

Finally, several miscellaneous sections should be amended. Debtors filing jointly should no longer be permitted to claim exemptions individually under section 522(m).[205] Congress also should remove the exemption for property held as a tenancy by the entirety[206] because it simply has no place in any exemption law.[207] Further, section 541(c)(2) should be deleted to eliminate the practical exemption of debtors' interests in spendthrift trusts.[208]

One change that should not be made in the Bankruptcy Act's exemption policy is the credit industry's proposal to amend section 522(d)(3)[209] to place a $3,000 limit on the aggregate value of exempt household goods.[210] The types of property exempted in that provision are virtually the same as the types listed in section 522(f)(2).[211] In enacting the latter provision Congress correctly observed that these types of property have little resale value relative to their replacement cost or to their value to their owners.[212] The existing $200 per item limitation satisfactorily insures that more substantial assets, for which there is likely to be a secondhand market, will not be exempted under that provision.[213]

In addition to restricting exemptions that are available in chapter 7 proceedings, Congress should contemplate changing chapter 13 itself. Because the liberal chapter 13 discharge has not worked well and is not supported by sound policy,[214] it should be reconsidered. Further, Congress should consider limiting the frequency with which debtors may seek discharges in chapter 13.[215] Although it is beyond the scope of this article, the availability of unlimited discharges countenances lax credit habits. The credit industry's mandatory repayment proposal[216] might be appropriate for those debtors who seek discharges more than once every six years.

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205. *See supra* notes 80-84 and accompanying text (criticizing separate exemptions for husband and wife filing jointly).

206. 11 U.S.C. § 522(b)(2)(B) (Supp. V 1981).

207. *See* Vukowich, *supra* note 77, at 792-93.

208. *See supra* note 78 and accompanying text (advocating elimination of practical exemption for spendthrift trusts).

209. 11 U.S.C. § 522(d)(3) (Supp. V 1981) (exempting household goods and certain other items, provided that each item's value does not exceed $200).

210. *Reform Hearings*, pt. 1, *supra* note 2, at 23 (statement of Andrew Brimmer) (credit industry advocates cap of $3,000 per debtor or $6,000 per couple on household furnishings exemptions); *id.* at 76 (statement of Claude Rice, Alvin Wiese, Jr., and Jonathan Landers) (advocating $3,000 cap); *see id.* at 65 (credit industry proposal aimed at curbing debtors who have numerous items of substantial aggregate value). The National Bankruptcy Conference "took no position" on the issue whether section 522(d)(3) should be amended. *See id.* at 193.

211. 11 U.S.C. § 522(f)(2) (Supp. V 1981) (allowing debtor to avoid nonpurchase money security interests in exempt household goods and certain other property).

212. H.R. REP. NO. 595, *supra* note 7, at 127, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6088.

213. Most debtors now are able to use section 522(d)(5)'s $7,900 "any property" exemption to exempt property that fits under section 522(d)(3) but exceeds the $200 per item limit. *In re* Boozer, 4 Bankr. 524 (Bankr. N.D. Ga. 1980). If the "any property" exemption is limited to $3,000, as this article recommends, the amount of property that a debtor could exempt in this manner would be reduced.

214. *See supra* notes 61-73 and accompanying text.

215. Unlike chapter 7, which limits the frequency with which debtors may obtain discharges, 11 U.S.C. § 727(a)(9) (Supp. V 1981), chapter 13 does not limit the frequency of discharges.

216. *See supra* notes 104-12 and accompanying text.

V. CONCLUSION

The current thrust of bankruptcy reform is understandable given the increased rate of filings and the notorious cases that highlight deficiencies in the new Act. Nonetheless, it would be precipitous to undertake a major reform of bankruptcy law because the new Act contributes only minimally to the increased rate of filings. The Act is basically the same as its predecessor, which generally has served social needs well and has withstood the test of time. Although serious deficiencies in the new Act have become apparent and Congress' goals have not been realized, amendments can correct the situation while preserving the Act's fundamental structure. Such amendments are outlined in the last section of this article. Certainly this approach is preferable to those that undermine the basic structure of a time-tested bankruptcy scheme and force debtors and their families to adhere to strict budgets based on different judges' evaluations of what life styles they deserve.

Market Power and Secondary-Line Differential Pricing

HERBERT HOVENKAMP*

The Supreme Court has declared that the anti-price discrimination provisions of the Robinson-Patman Act must be interpreted so as not to undermine the policy of other federal antitrust laws. Asserting that consumer welfare as well as the efficient allocation of resources should be underlying goals of all antitrust legislation, Professor Hovenkamp argues that achievement of these goals can be facilitated in secondary-line Robinson-Patman claims by requiring the plaintiff to prove the defendant's market power as an element of its prima facie case. Professor Hovenkamp demonstrates that although discriminatory pricing by a seller with market power distributes wealth from consumers to producers and causes allocative inefficiency, it is implausible that differential pricing by a seller without market power could operate to reduce output or damage consumer welfare.

In its decision in *J. Truett Payne Co. v. Chrysler Motors Corp.*[1] the Supreme Court remanded a secondary-line Robinson-Patman Act claim,[2] instructing the lower court to consider whether the alleged price discrimination had caused "antitrust injury."[3] With this decision, the Court lost an important opportunity to require the plaintiff bringing a secondary-line case to prove that the defendant had sufficient market power to engage in discriminatory

* Associate Professor of Law, the University of California, Hastings College of Law.

1. 451 U.S. 557 (1981).

2. The Robinson-Patman Act's antidiscrimination provision provides:

> (a) It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States . . . , and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .

15 U.S.C. § 13(a)(1976).

A "secondary-line" Robinson-Patman case is one in which the plaintiff competes with other customers of the price discriminator, and other customers paid less than the plaintiff for similar goods. As a result, the plaintiff is allegedly placed at a competitive disadvantage vis-a-vis the other customers. *See* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1040 (9th Cir. 1982) (primary-line case defining various causes of action under the Robinson-Patman Act), *cert. denied*, 103 S. Ct. 57 (1982). A primary-line case is one in which the plaintiff is in competition with the seller-defendant that has charged the allegedly discriminatory prices. Primary-line cases are considered as a form of predatory pricing. *See id.* In addition, the Robinson-Patman Act proscribes so called "third-line" and "fourth-line" injuries—that is, injuries that accrue to indirect purchasers further down the distributive chain. *See id.* at 1040 n.46; *see also*, Standard Oil Co. v. FTC, 340 U.S. 231 (1951) (third-line injury); Perkins v. Standard Oil Co., 395 U.S. 642 (1969) (fourth-line injury).

3. *J. Truett Payne*, 451 U.S. at 558-69. The lower court subsequently decided that there was no antitrust injury and dismissed the complaint. Chysler Credit Corp. v. J. Truett Payne Co., Inc., 670 F.2d 575, 580-84 (5th Cir. 1982).

pricing.[4]

The protection of consumer welfare should be an underlying goal of all federal antitrust laws, including the Robinson-Patman Act. Application of the consumer welfare principle to the Robinson-Patman Act is controversial, however, because the obvious intention of the framers of the Act was to preserve the traditional marketing system of independent retailers against the growing consumer appeal of low-priced mass distributors.[5] Nevertheless, the Supreme Court has declared that the Robinson-Patman Act must be interpreted in a manner consistent with the policy of the other antitrust laws.[6] Indeed, in *J. Truett Payne* the Court suggested that consumer welfare should be a consideration in Robinson-Patman cases.[7] Likewise, some circuit court decisions have addressed the consumer welfare principle in primary-line Robinson-Patman cases.[8]

Assuming that the consumer welfare principle applies to the Robinson-Patman Act, any analysis of the law's application must necessarily consider its impact upon consumers. There are only two instances in which differential pricing [9] can plausibly cause consumer injury. Both of these instances require the seller to have market power.

First, consumers may be injured by differential pricing when the seller engages in supra-marginal cost pricing. However, only a seller with market power can persistently obtain a price greater than marginal cost from any set of customers. In a competitive market customers will simply switch to sellers willing to sell to them at a competitive price.[10]

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4. Market power is the ability of a seller to restrict output and raise prices above marginal costs without losing so many sales that the output reduction is unprofitable. *See infra* note 31 and accompanying text. The Supreme Court's opinion in *J. Truett Payne* never even raised the question of the defendant's market power. The proposal advanced here, that a demonstration of the defendant's market power should be required as a prima facie element of a secondary-line Robinson-Patman Act claim, applies equally to so-called third-line and fourth-line claims. *See supra* note 2 (defining third- and fourth-line injuries). In its recent decision in Falls City Indus., Inc. v. Vanco Beverage, Inc., 51 U.S.L.W. 4275, 4279 (U.S. March 22, 1983) the Court noted that the plaintiff suggested market power as an explanation for industry-wide price discrimination. The Court suggested that a more plausible explanation of the price difference was extensive state regulation of beer pricing in the high-price market (Indiana) but not in the low-price market (Kentucky). *Id.*

5. The Robinson-Patman Act was designed to redistribute wealth at the retail level, diverting it from a few large national chains to smaller local businesses. *See* F. ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 3-11 (1962).

For an excellent analysis of the historical background and legislative history of the Robinson-Patman Act, *see id.* at 3-23; *see also* UNITED STATES DEP'T OF JUSTICE, REPORT ON THE ROBINSON-PATMAN ACT 101-39 (1977) (discussing economic and political crisis of post-Depression era and legislative history of Robinson-Patman Act) [hereinafter JUSTICE DEP'T REPORT].

6. Great A. & P. Tea Co. v. FTC, 440 U.S. 69, 80 n.13 (1979); United States v. United States Gypsum Co., 438 U.S. 422, 458 (1978).

7. *J. Truett Payne*, 451 U.S. at 564-65 & n.4 (1981) (discussing impact of discrimination on retail prices in secondary-line case).

8. *See* Williams Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1040-42 (9th Cir. 1981), *cert. denied*, 103 S. Ct. 57 (1982); O. Hommel Co. v. Ferro Corp., 659 F.2d 340, 346-47 (3d Cir. 1981), *cert. denied*, 102 S. Ct. 1711 (1982).

9. In economic terms, "differential pricing" occurs when the same product is sold to two purchasers at two different prices. *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 62 (1976). "Price discrimination" occurs when two different sales produce two different rates of return for the seller. *See id. See also infra* notes 18-24 and accompanying text (discussing treatment of differential pricing and price discrimination under the Robinson-Patman Act).

10. *See infra* note 31 and accompanying text (discussing pricing capabilities of sellers with and without market power).

Second, consumers may be injured by differential pricing when a seller operating in two or more markets engages in predatory pricing in one market. Under these circumstances, a secondary-line cause of action may be filed by customers in one of the high-priced markets—that is, a market that is not the locus of the predatory activity. The disfavored customer does not suffer compensable injury to its business or property, however, unless the predator has actually raised prices in the plaintiff's market to finance its predation in the other market.[11] Without market power in the plaintiff's market, however, the defendant could not sustain the higher prices alleged to have caused secondary-line injury.[12]

The most appropriate method of identifying true secondary-line price discrimination, then, is to require the plaintiff bringing such a claim under the Robinson-Patman Act to prove that the defendant has sufficient market power to engage in persistent discriminatory pricing. If that proof fails, the defendant's price differential is either justified by different marginal costs,[13] or it does not adversely affect consumer welfare or the efficient allocation of resources.[14]

I. PRICE DISCRIMINATION AND DIFFERENTIAL PRICING UNDER THE ROBINSON-PATMAN ACT

If the evil that the Robinson-Patman Act is designed to prevent is economic price discrimination, it does a poor job because the Act, as construed by the courts, is both overinclusive and underinclusive. Economic price discrimination occurs whenever two sales of the same product produce two different rates of return: that is, when the ratio of price to marginal cost is different for one sale than it is for the other.[15] It makes no difference whether the price discrimination exists because the seller has the same marginal costs for two sales but different prices, different marginal costs but the same prices, or different marginal costs and different prices. In any of these cases, true economic price discrimination exists.

Differential pricing, on the other hand, simply occurs whenever the same product is sold to two purchasers at two different prices.[16] Differential pricing may indicate true economic price discrimination or it may reflect the varying costs of serving different classes of purchasers, and thus be cost justified and non-discriminatory. Nevertheless, courts have interpreted the Robinson-Patman Act to prohibit differential pricing rather than true economic price

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11. Section 4 of the Clayton Act provides that "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . ." 15 U.S.C. § 15 (1976 & Supp. V).

12. *See infra* notes 74-78 and accompanying text (arguing that even when a seller engages in predatory pricing, a secondary-line Robinson-Patman suit is generally not the proper vehicle for identifying and condemning the undesirable conduct).

13. *See infra* note 20 and accompanying text (discussing cost-justification defense of the Robinson-Patman Act). Even where a seller does have market power, however, differential pricing may still be justified by different marginal costs. *See infra* text accompanying and following note 79.

14. *See infra* notes 49-53 and accompanying text (asserting that some instances of differential pricing occur in competitive markets but do not harm consumer welfare), and notes 60-78 and accompanying text (arguing that seller without market power cannot cause secondary-line injury by attempting to employ differential pricing to obtain supra-maginal profits or enforce a predatory pricing scheme).

15. *See* R. POSNER, *supra* note 9, at 62.

16. *See id.*

discrimination.[17]

Courts applying the Robinson-Patman Act do not consider differences in marginal cost if the prices paid by different purchasers are the same in each sale.[18] Two sales at the same price that produce two different rates of return, reflecting true economic price discrimination, simply do not violate the Act. As a result, the Robinson-Patman Act is underinclusive in restricting only differential pricing while ignoring instances of true economic price discrimination that occur in same-price sales.[19]

Although courts applying the Robinson-Patman Act do not consider differences in marginal costs if the actual price paid by different customers is the same, the Act does look to marginal costs when the prices are not the same in order to determine whether the price differential is actually nondiscriminatory. The Act contains an explicit cost-justification defense that enables a defendant charged with differential pricing to show that two sales at two different prices are actually nondiscriminatory.[20] This defense recognizes that sales at different prices do not constitute true economic price discrimination if the ratio of the two prices is the same as the ratio of the marginal costs of the two sales.

The cost-justification defense, however, has not saved many defendants. The burden of proving cost justification is on the defendant.[21] Furthermore, although it is almost impossible to show marginal costs per sale on a customer-by-customer basis,[22] judicial interpretation of the cost-justification defense has come very close to imposing such a requirement.[23] Consequently, few defend-

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17. *See* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 549 (1960) (price discrimination within meaning of Robinson-Patman Act is merely a price difference); *see also* FTC v. Cement Institute, 333 U.S. 683, 725 (1948) (section 2 of Robinson-Patman Act forbids price system in which seller consistently receives more money for like goods from one customer than from another); R. POSNER, THE ROBINSON-PATMAN ACT: FEDERAL REGULATION OF PRICE DIFFERENCES 35 (1976) (Robinson-Patman Act prohibits price differences, not economic price discrimination).

18. *See* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 549 (1960); Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 119 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981); National Dairy Prods. Corp. v. FTC, 412 F.2d 605, 612 (7th Cir. 1969); American Can Co. v. Bruce's Juices, Inc., 187 F.2d 919, 923 (5th Cir.), *cert. dismissed*, 342 U.S. 875 (1951); Guyott Co. v. Texaco, Inc., 261 F. Supp. 942, 948 (D. Conn. 1966); *see also* R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 383 (1978) (Robinson-Patman Act ignores economic price discrimination when prices charged are the same).

19. *See* F. ROWE, *supra* note 5, at 30-31 (as interpreted, Robinson-Patman Act ignores some instances of economic price discrimination).

20. 15 U.S.C. § 13(a) (1976) ("[n]othing herein contained shall prevent [price] differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered").

21. 15 U.S.C. § 13(b) (1976); *see* United States v. Borden Co., 370 U.S. 460, 467 (1962); *see also* FTC v. Morton Salt Co., 334 U.S. 37, 44-45 (1948) (statutory language and history support construction requiring defendant to bear burden of proof of cost-justification under the Act).

22. *See* Standridge, *An Analysis of the Cost Justification Defense under Section 2(a) of the Robinson-Patman Act*, 9 RUT.-CAM. L. J. 219, 228-36 (1978); Murray, *Cost Justification Under the Robinson-Patman Act: Impossibility Revisited*, 1960 WISC. L. REV. 227; Kuenzel & Schiffres, *Making Sense of Robinson-Patman: The Need to Revitalize its Affirmative Defenses*, 62 VA. L. REV. 1211, 1225-27 (1976). *See generally* R. BORK, *supra* note 18, at 391-94 (discussing seller-defendant's inability to calculate cost in economic sense); G. STIGLER, THE THEORY OF PRICE 105 (3d ed. 1966) (discussing complex nature and components of economic concept of cost).

23. *See* United States v. Borden Co., 370 U.S. 460, 467-69 (1962) (allowing grouping of like customers only if similarities indicate that average cost of dealing with group is reasonable indicator of dealing with specific member); National Dairy Prods. Corp. v. FTC, 395 F.2d 517, 524-27 (7th Cir.) (disallowing grouping of all chain customers and all independent customers because little resemblance of individuals within each group), *cert. denied*, 393 U.S. 977 (1968). Some sellers have successfully asserted

ants succeed in showing cost-justification, and the Act as applied is overinclusive because it condemns many instances of nondiscriminatory differential pricing. Certainly, considerable overlap exists between instances of differential pricing and price discrimination. It may also be true that many bank robbers run traffic lights. We would not regard that correlation, however, as sufficient to convict those running red lights of bank robbery. If the evil that the Robinson-Patman Act was designed to measure is economic price discrimination, it does so poorly in failing to look beyond differential pricing for evidence of actual price discrimination. Moreover, without a viable cost-justification defense the statute actually requires some defendants to engage in true economic price discrimination by requiring them to sell their output to all customers at the same price, regardless of differing marginal costs.[24]

Good policy reasons exist for encouraging some differential pricing, particularly when it reflects differences in marginal costs.[25] A seller's marginal costs can vary considerably from one sale to another, depending on the size of the sale, the distance from the seller to the buyer (if the seller pays delivery costs), and other terms of the sale. As a general rule, allocative efficency and consumer welfare are optimized when each customer is charged a price equal to the marginal cost of serving that particular customer.[26] Thus, under ideal circumstances two customers that impose the same marginal costs upon the seller should be charged the same price. Two customers that impose different marginal costs upon the seller should be charged two different prices, in proportion to the difference in marginal costs.[27]

Deviation from marginal-cost pricing generally causes allocative inefficency. When a seller offers a group of potential customers a product at a price greater than the marginal cost of production and delivery, some customers that would be willing to purchase the product at marginal cost will instead select a different product. These substitutions are inefficient because they represent the second-best use of resources when the best use is possible. On the other hand, when a seller offers a group of customers a product at less than the marginal cost of production and delivery, as it would if it were engaged in predatory pricing, some customers will choose to purchase the product even though they would have been unwilling to purchase it at marginal cost. This choice represents an inefficient use of resources because the value that the customer places on the product is less than the value of the resources consumed in producing and delivering it to him. Thus, when differential pricing is employed by a seller with market power, the resulting price discrimination may injure consumer welfare and result in the inefficient allocation of resources.[28] In the ab-

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the cost-justification defense. *See* Morton v. National Dairy Prods. Corp., 414 F.2d 403, 406-07 (2d Cir. 1969), *cert. denied*, 396 U.S. 1006 (1970); American Motors Corp. v. FTC, 384 F.2d 247, 251-59 (6th Cir. 1967), *cert. denied*, 390 U.S. 1012 (1968); FTC v. Standard Motor Prods., Inc., 371 F.2d 613, 618-22 (2d Cir. 1967).

24. *See* F. ROWE, *supra* note 5, at 303-06 (as interpreted Robinson-Patman Act ignores some instances of economic price discrimination while compelling others).

25. Differential pricing may also be desirable when it signals the breakup of a cartel or oligopoly. *See infra* notes 51-53 and accompanying text.

26. *See* G. STIGLER, *supra* note 22, at 178-80.

27. *See infra* text following note 53.

28. *See infra* notes 38-48 and accompanying text.

sence of market power, however, differential pricing does not violate either of these interests, whether or not it constitutes price discrimination.[29]

Therefore, the simple identification of instances of differential pricing should not be determinative of secondary-line price discrimination under the Robinson-Patman Act. Rather, the focus should be on whether a seller is causing a harm condemned by the federal antitrust laws. Recognizing whether or not the defendant has sufficient market power to engage in true economic price discrimination facilitates this determination.

II. TRUE SECONDARY-LINE PRICE DISCRIMINATION BY A SELLER WITH MARKET POWER

A seller must have market power to engage in systematic price discrimination. If the seller does not have market power, disfavored purchasers that are asked to pay a price above marginal cost will seek a seller willing to provide the product at a competitive price. If a seller has market power, however, it may be able to enlarge its profits by engaging in systematic price discrimination.[30] The initial consideration must be, then, whether this situation causes a harm that the antitrust laws, including the Robinson-Patman Act, are intended to prevent.

Theorists who maintain that allocative efficiency should not be the only concern of the antitrust laws recognize true economic price discrimination as an important problem because it results in the transfer of wealth from consumers to producers. For theorists who stress allocative efficency as the predominant concern of antitrust legislation, however, the question is more complex. Although the latter group argues that price discrimination is unobjectionable when it encourages competitive levels of output, in the real world price discrimination may actually produce an inefficient allocation of resources. Therefore, to the extent that secondary-line enforcement of the Robinson-Patman Act identifies such behavior by sellers with market power, the statute promotes allocative efficiency as well as consumer welfare.

A. PERFECT PRICE DISCRIMINATION

Figure One illustrates the consequences of perfect price discrimination by a seller with substantial market power. A seller in a perfectly competitive market must price its output at marginal cost, $P_{(c)}$. A monopolist, on the other hand, faces a downward sloping demand curve and can obtain a higher price per unit of output by restricting production. To maximize profits a producer with market power will price its output at the intersection of the marginal cost and marginal revenue curves, the point at which production and sale of one more unit would result in greater additional costs than additional revenues. The monopoly price in Figure One, $P_{(m)}$, falls at the spot on the demand curve

29. *See infra* notes 49-53 and accompanying text (asserting that instances of differential pricing occur in competitive markets but do not harm consumer welfare) and notes 60-78 (arguing that seller without market power cannot cause secondary-line injury by attempting to employ differential pricing to obtain supra-marginal profits or enforce a predatory pricing scheme).

30. The origin of the market power—whether from predation or inventive genius—is irrelevant. Both legal and illegal monopolists have the power to discriminate on the basis of price.

directly above the intersection of marginal cost and marginal revenue. This is the monopolist's nondiscriminatory profit-maximizing price. The monopolist that sells all of its output at a single price will maximize profits by selling at price $P_{(m)}$.[31]

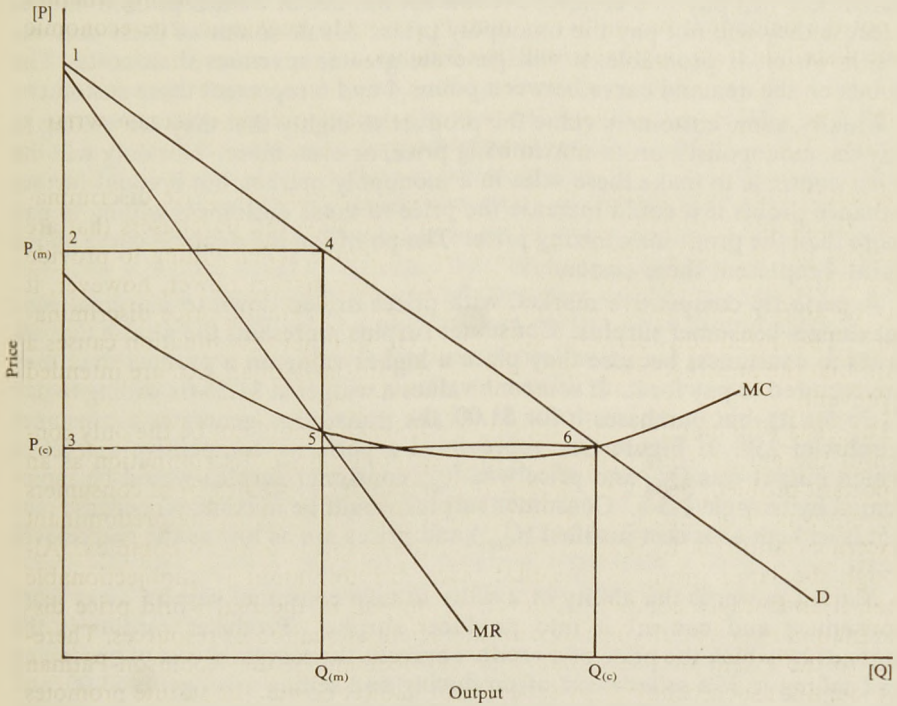

FIGURE ONE

To sell its entire output at the nondiscriminatory profit-maximizing price, the monopolist must reduce output because fewer buyers will pay the profit-maximizing price than will pay the competitive price.[32] Economic analysts identify this reduction in output as one of the greatest evils of monopoly. It forces some buyers that would be willing to pay the cost of an article in a competitive market to buy other, less attractive products instead.[33]

Different customers or potential customers value a product differently. Some potential customers, unwilling to purchase the product even if it is sold

31. For a more comprehensive analysis of competitive and monopoly pricing, *see* R. POSNER, ECONOMIC ANALYSIS OF LAW 195-205 (2d ed. 1977); R. LEFTWICH, THE PRICE SYSTEM AND RESOURCE ALLOCATION 229-95 (7th ed. 1979); G. STIGLER, *supra* note 22, at 176-215.

32. Competitive, marginal-cost pricing yields an output of $Q_{(c)}$ on the graph. Monopolistic pricing yields an output of $Q_{(m)}$.

33. *See* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 460 (2d ed. 1980). For a critique see Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 991-95 (1981).

at marginal cost in a perfectly competitive market, might be willing to purchase the product if it is sold at a price below marginal cost.[34] The points on the demand curve below point 6 represent these customers.

Other customers will be willing to pay more than marginal cost for the product, but not as much as its nondiscriminatory profit-maximizing price. These purchasers will buy in a competitive market but not in a monopolized market because they will not pay the monopoly price. A sale to one of these customers, however, is profitable; it will generate greater revenues than costs. The points on the demand curve between points 4 and 6 represent these customers.

Finally, some customers value the product so highly that they are willing to pay the monopolist's profit-maximizing price, or even more. Not only will the seller continue to make these sales in a monopoly market, but it could further enhance profits if it could increase the price to those customers willing to pay more than the profit-maximizing price. The points on the demand curve above point 4 represent these customers.

A perfectly competitive market, with prices driven down to marginal cost, maximizes consumer surplus. Consumer surplus represents the wealth that accrues to consumers because they place a higher value on a product than they are required to pay for it. If someone values a widget at $1.25 (is willing to pay $1.25 for it), but purchases it for $1.00, the transaction generates a consumer surplus of 25¢. If Figure One represented a perfectly competitive market in which output was $Q_{(c)}$ and price was $P_{(c)}$, consumer surplus would be represented by triangle 1-3-6. Consumer surplus would be maximized because output is as high as is cost-justified ($Q_{(c)}$) and prices are as low as the market will bear.

Market power is the ability of a seller to take consumer surplus away from consumers and convert it into producer surplus. Producer surplus is the amount by which the price of a product exceeds the marginal cost of producing and selling it. If a seller's cost of producing and selling a widget is $1.00, and the seller is able to sell it for $1.25, the transaction generates a producer surplus of 25¢.

If any seller in a perfectly competitive market attempts to sell its output at more than marginal cost, consumers will purchase from a seller willing to sell at a lower price. A seller with market power, however, by reducing output to $Q_{(m)}$ and selling it at price $P_{(m)}$, can convert a certain amount of consumer surplus, represented by rectangle 2-3-5-4, into producer surplus. The seller is not able to convert all consumer surplus; some portion of it, represented by triangle 4-5-6, is lost. This portion does not accrue to the producer because it represents value lost when purchasers choose not to buy the product at the profit-maximizing price and instead substitute away. Triangle 4-5-6 is thus thought to represent this "deadweight loss" of monopoly: lost value that accrues to neither consumers or producers.

Monopoly, therefore, has a two-fold effect. First, it transfers wealth from consumers to producers. Second, it produces an inefficient allocation of resources because part of the value lost to consumers is simply lost; it does not

34. The product might be sold below cost, for example, if the seller is engaged in predatory pricing.

accrue to anyone.[35] Those who believe that antitrust law should be concerned exclusively with allocative efficiency regard deadweight loss as the only problem of monopoly.[36] Those who believe that the antitrust laws incorporate distributive goals conclude that both the deadweight loss and transfer of wealth from consumers to producers are antitrust concerns.[37]

Even the monopolist charging a price of $P_{(m)}$ does not make all the money theoretically possible from the sale of its output. First, profitable sales to customers located between points 4 and 6 on the demand curve are lost. These customers value the product highly enough to pay a profitable price but not the profit-maximizing price. Second, the monopolist does not charge as high a price as it could to customers located between points 1 and 4 on the demand curve. These customers are willing to pay more than $P_{(m)}$. For the monopolist, a price of $P_{(m)}$ is merely the *nondiscriminatory* profit-maximizing price.

The perfect world for a seller is one in which it can make every sale to every customer at a price equal to the value that the customer places on the product. The seller could theoretically convert all consumer surplus, triangle 1-3-6, into producer surplus. This seller would achieve perfect price discrimination.

Two observations about perfect price discrimination are important. First, it represents the largest possible transfer of wealth from consumers to producers—theoretically, all consumer surplus is converted to producer surplus.[38] Second, in perfect price discrimination output is restored to $Q_{(c)}$—the same level it would reach under perfect competition. In a perfectly competitive market, every customer willing to pay the marginal cost of producing a widget can obtain one. The same is true under the perfect price discrimination model. In short, although perfect price discrimination represents a large transfer of wealth, within the model it does not misallocate resources; it should not produce any deadweight loss.[39]

This effect of perfect price discrimination has caused a division among antitrust analysts. Theorists who believe that the antitrust laws should incorporate values beyond allocative efficiency[40] regard price discrimination as a pressing

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35. The size of the deadweight loss, however, must be adjusted by the amount of consumer surplus generated by the substitute transactions. Suppose that the competitive price of widgets is $1.00 and the monopoly price is $1.25. A consumer in the monopoly market who values widgets at $1.24 will select another product. Suppose the consumer purchases for $1.00 a product that she really values at $1.10. The deadweight loss with respect to this consumer is not 24¢, but 14¢—the amount of net consumer surplus lost. Substitutions thus make the calculation of the size of deadweight loss caused by monopoly very difficult.

36. *See* R. BORK, *supra* note 18, at 100-01; Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 934-35 (1979); *see also* 1 P. AREEDA & D. TURNER, ANTITRUST LAW 22-33 (1978).

37. *See* Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1176-90 (1981) (asserting values other than efficiency should be incorporated into antitrust law); Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076, 1080-81 (1979) (courts should give proper deference to noneconomic goals of antitrust laws); Schwartz, *On the Uses of Economics: A Review of Antitrust Treatises*, 128 U. PA. L. REV. 244, 257-61 (1979) (courts should apply principles of justice to price discrimination cases); Sullivan, Book Review, 75 COLUM. L. REV. 1214, 1222 (1975) (courts should consider history and sociology, as well as economics, to apply antitrust laws properly). *See generally* Lande, *Wealth Transfer as the Original and Primary Concern of Antitrust: the Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982).

38. *But see infra* notes 44-45 and accompanying text (arguing that even perfect price discrimination produces deadweight loss).

39. For a concise analysis of perfect price discrimination, *see* R. POSNER, *supra* note 17, at 3-10.

40. *See supra* note 37.

legal concern. Theorists who believe that the antitrust laws should be concerned only with allocative efficiency and not with distribution of wealth, however,may believe that price discrimination is not an antitrust problem.[41] Those who place the highest value on allocative efficiency agree that market power is generally not socially beneficial and that competition is preferable to monopoly.[42] Nevertheless, they argue that it is socially preferable for a seller with substantial market power to engage in price discrimination rather than nondiscriminatory monopolistic pricing. These theorists assert that price discrimination is preferable because it maintains high levels of output and avoids the substantial deadweight loss of monopoly pricing.[43] The assumption that price discrimination avoids the deadweight loss of monopoly, however, is vulnerable.

B. PRICE DISCRIMINATION AND DEADWEIGHT LOSS

Even for those who regard allocative efficency as the primary goal of antitrust legislation, there are nevertheless two compelling reasons for recognizing price discrimination as a significant antitrust concern. First, although perfect price discrimination results in optimum output, perfect price discrimination can produce substantial deadweight loss, perhaps even greater than that resulting from nondiscriminatory monopoly pricing. Secondly, in the real world price discrimination is never perfect. Imperfect price discrimination need not result in greater output than nondiscriminatory monopoly pricing, and it may result in lower output. In that case, the deadweight loss of price discrimination can be larger than the deadweight loss of monopoly pricing. In the real world, therefore, price discrimination by a seller with market power not only distributes wealth from consumers to producers, but is inefficient as well. Consequently, price discrimination is undesirable regardless of one's basic antitrust ideology.

Perfect Price Discrimination. The assertion that all price discrimination, even perfect price discrimination, results in deadweight loss comes from Judge Posner.[44] Posner argues that the perfect price discrimination model ignores the seller's willingness to spend a substantial amount of money to acquire and maintain market power.

Initially, calculation of a monopolist producer surplus overlooks the seller's costs of acquiring and maintaining its market power. If the marginal cost of producing a widget is $1.00, and the profit-maximizing price that a seller with a certain amount of market power could charge is $1.25, a seller will be willing to spend as much as 25¢ per unit to acquire and maintain that market power. The amount of wealth that transfers to the producer under nondiscriminatory monopoly pricing (rectangle 2-3-5-4 in Figure One), therefore, must be re-

41. *See* R. BORK, *supra* note 18, at 394-401.
42. *See id.* at 100-01.
43. *Id.* at 394-401.
44. *See* Posner, *The Social Cost of Monopoly and Regulation*, 83 J. POL. ECON. 807, 822 (1975); R. POSNER, *supra* note 9, at 11-13; R. POSNER, *supra* note 17, at 10-12; Hovenkamp, *Distributive Justice and the Antitrust Laws*, 51 GEO. WASH. L. REV. 1 (1982). For a critique of Posner's argument, see R. BORK, *supra* note 18, at 112-13.

duced by the amount of money that the monopolist spends to acquire and maintain monopoly power.

The monopolist may spend some of this money in socially useful ways, such as cost-justified research and development. Much of it, however, may be spent in ways that are not socially beneficial, including false advertising, interference with potential competitors, vexatious litigation, or bribery. These expenditures, which must be deducted from rectangle 2-3-5-4, represent deadweight loss rather than a transfer of wealth to the producer.

Similarly, the monopolist engaged in perfect price discrimination rather than nondiscriminatory monopolistic pricing produces substantial deadweight loss. The value of perfect price discrimination to the monopolist in Figure One is represented by triangle 1-3-6. The monopolist will presumably spend up to that amount to acquire and maintain the market power necessary to engage in perfect price discrimination. Moreover, these expenses for the price discriminator will be greater than for the nondiscriminating monopolist because they include not only the cost of acquiring and maintaining market power, but also the cost of engaging in price discrimination.[45] This latter figure includes the cost of identifying groups of customers that place different values on the product, segregating those groups, and preventing arbitrage.

As a result, when a seller with market power engages in perfect price discrimination, much of triangle 1-3-6 is not producer surplus at all, but deadweight loss. To the extent that perfect price discrimination generates deadweight loss, it is less efficient than competitive pricing. Moreover, the deadweight loss will be greater than it is for nondiscriminatory monopolistic pricing because of the additional costs of developing a price discrimination scheme.

Imperfect Price Discrimination. The above analysis understates the social cost of price discrimination. In the real world no seller can engage in perfect price discrimination. The cost of identifying the value that each prospective purchaser places on the seller's product would be prohibitive. Furthermore, any amount of arbitrage—that is, sales by favored purchasers to disfavored purchasers—would defeat perfect price discrimination.[46] The best most sellers can do is segregate two or more different groups of customers that place different values on the seller's product, and price discriminate among them.

Figure Two, like Figure One, illustrates a seller with market power. Assume that the seller's marginal cost is $1.00 per widget and that its nondiscrimina-

45. *See* Posner, *The Social Cost of Monopoly and Regulation*, 83 J. POL. ECON. 807, 822 (1975).

46. A seller actually needs to worry about arbitrage only if the price discrimination is in the form of price differentials. If the price to all customers is the same, and the discrimination is the result of differing marginal costs, arbitrage would be unprofitable.

It is difficult to imagine instances of near-perfect price discrimination in the real world. When it is possible, it is likely to be service discrimination, not commodity discrimination, since arbitrage is much more difficult in the former. For example, a dentist who became very good at guessing the value that each patient placed on an extraction, and then charged that price, would not need to worry about arbitrage. Nevertheless, the Robinson-Patman Act does not apply to discrimination in the pricing of services. *See* Baum v. Investors Diversified Servs., Inc., 409 F.2d 872, 874 (7th Cir. 1969); Gaylord Shops, Inc. v. Pittsburgh Miracle Mile Town & Country Shopping Center, Inc., 219 F. Supp. 400, 403 (W.D. Pa. 1963).

tory profit-maximizing price is $1.50. Assume also that the seller believes it has identified three groups of consumers: A low-preference group (group X) values the product at $1.25; a medium-preference group (group Y) values it at $1.50; and a high-preference group (group Z) values it at $1.75. Several mechanisms are available to the seller for discriminatory pricing among these three groups. The seller could market the product in three different packages: "Good," "better," and "best." The seller could also sell the product in three different kinds of stores: Discount stores, department stores, and boutiques. Finally, the seller could exploit the customers' differing needs for delivery, set-up, and instruction.[47]

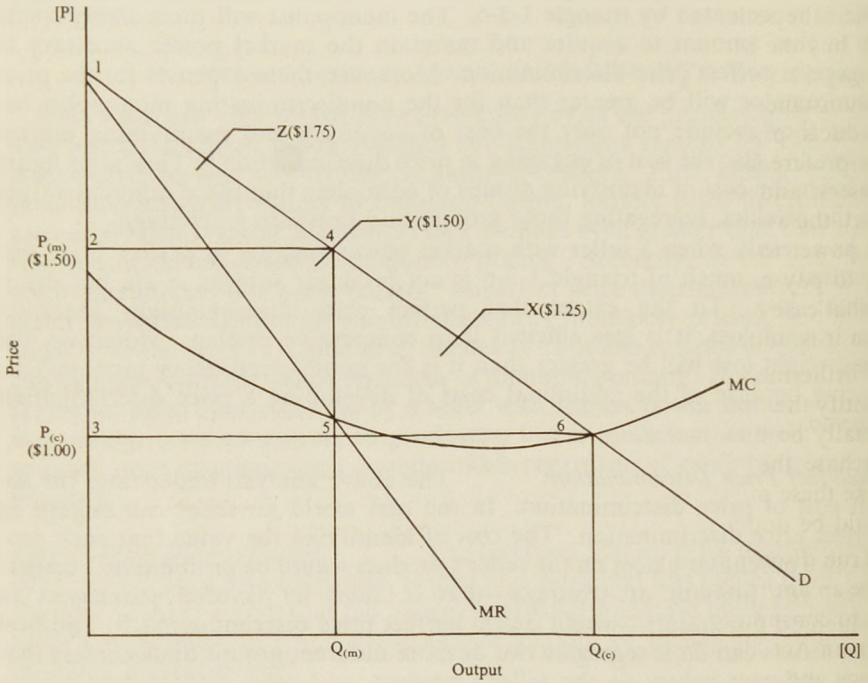

FIGURE TWO

47. To the extent these price differentials reflect the differing costs of providing the products they do not represent price discrimination at all.

Another way that a seller can engage in price discrimination is through variable proportion tying arrangements. For example, a seller that has market power in copying machines may have some high-intensity users who value the machine highly, as well as some low-intensity users who place a lower value on the machine but nevertheless are willing to buy or lease it at marginal cost. The seller could sell the machine at one price, but require the purchaser to purchase all of its ink from the seller at the supra-competitive price. *See e.g.* Henry v. A. B. Dick Co., 224 U.S. 1 (1912). Thus the seller's rate of return from high-volume users would be greater than from low-volume users. Although true price discrimination occurs, no differential pricing within the purview of the Robinson-Patman Act occurs because the seller charges both users the same price for the machine and the same price per unit for the ink.

For a general discussion of the use of tying arrangements as price discrimination devices,*see* R. POSNER, *supra* note 9, at 173-184; Markovits, *Tie-in, Leverage, and the American Antitrust Laws*, 80

The seller's evaluation may lead to the conclusion that the product is marketable to these three different classes of customers at prices of $1.25, $1.50, and $1.75. The seller's output would thus be higher under price discrimination than it would be if the seller simply charged its nondiscriminatory profit-maximizing price. Every customer willing to pay at least the nondiscriminatory profit-maximizing price will purchase the product, but in addition the seller will make sales to group X, which consists of customers unwilling to pay the profit-maximizing price, but willing to pay a price above marginal cost.

If the seller cannot discover a reliable mechanism for segregating the customers in group Y from those in group X, however, it may ignore the preferences of the customers in group X. For example, consider the situation in which the seller discovers that customers in group Y are cost conscious and will buy the $1.25 product if it is available, even though they would be willing to pay $1.50 if the $1.25 version were not available. The seller, under these circumstances, may decide that it is more profitable to sell only two classes of products, priced at $1.75 and $1.50, and ignore group X. As a general rule, low-preference purchasers are more cost conscious than high-preference purchasers, and sales to low-preference purchasers are the least profitable. In short, the availability of price discrimination may encourage a seller with market power to discriminate, but only *within* the group of customers that is willing to pay more than the seller's nondiscriminatory profit-maximizing price. In that case output under imperfect price discrimination will not be any larger than it is under nondiscriminatoy monopoly pricing.

Furthermore, the seller's attempt at price discrimination may imperfectly identify the optimal range of discrimination. Some customers in group Z may actually be unwilling to pay $1.75. However, they may also be unwilling to purchase the "inferior" $1.50 product, and consequently will choose not to make these purchases at all. Output in this case may actually be lower than it would be under nondiscriminatory monopoly pricing.[48]

True discriminatory pricing by sellers with market power, therefore, ought to be an antitrust concern. As a general rule, it is socially inefficient and injurious to consumers. To the extent secondary-line enforcement of the Robinson-Patman Act identifies such behavior, the statute promotes both allocative efficiency and consumer welfare.

YALE L.J. 195 (1970); Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957); Hovenkamp, *Tying Arrangements and Class Actions*, 36 VAND. L. REV. — (1983) (forthcoming).

Price discrimination by tying arrangements falls outside the jurisdiction of the Robinson-Patman Act not only because the price charged per unit of product is the same, but also because in many such cases the tying product is leased, and the Robinson-Patman Act applies only to sales of goods. *See* Export Liquor Sales, Inc. v. Ammex Warehouse Co., 426 F.2d 251, 252 (6th Cir. 1970), *cert. denied*, 400 U.S. 1000 (1971). The inapplicability of the Robinson-Patman Act to leases is simply another index of the disparity between the mechanics of price discrimination and the scope of the statute's coverage. *See supra* notes 17-24 and accompanying text (discussing inadequacies of Robinson-Patman Act in addressing problem of true economic price discrimination).

48. For more detailed analysis of imperfect price discrimination in real markets, *see* J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 188-95 (1933); R. LEFTWICH, THE PRICE SYSTEM & RESOURCE ALLOCATION 240-43 (5th ed. 1973).

III. Economic Price Discrimination and Secondary-Line Injury

Systematic, long-term price discrimination can be achieved only by a seller with market power. If the seller does not have market power, purchasers asked to pay the higher price will purchase from another seller willing to sell at a more competitive price. Nevertheless, true price discrimination, at least when it is not systematic and long-term, does not always involve sellers with market power. Therefore, although price discrimination by a seller with market power adversely affects consumer welfare and the efficient allocation of resources, the question nevertheless remains whether discriminatory pricing by a seller without market power should also be of concern in secondary-line Robinson-Patman cases.

There is a certain amount of price discrimination even in the most competitive markets. Perfect competition is as rare as perfect price discrimination; markets constantly adjust, conditions change, and as a result, we expect to see prices fluctuate daily.[49] This is all part of the process of healthy competition and does not represent an antitrust problem.[50] The Third Circuit recently held that such sporadic price differences, even though they may represent true instances of price discrimination, are not actionable under the Robinson-Patman Act.[51] As the court noted, even secret price concessions given by a seller in individually-negotiated transactions are not necessarily cause for antitrust concern.[52] We expect instability in market prices. The absence of price fluctuations is generally not a sign of competitition, but of cartel or oligopoly pricing. Secret price concessions or rebates are frequently the mechanism by which cartels or oligopolistic price structures are broken up.[53]

Price differentials caused not by price discrimination, but by the differing marginal costs of servicing different customers, are similarly harmless. A perfectly competitive market tends toward marginal cost pricing. Prices in a competitive market tend to differentiate themselves to account for differences in marginal cost associated with different classes of customers. If the marginal cost of producing a single crate of apples is $5.00, and the cost of producing ten crates is $4.50 per crate, in a competitive market we expect the price for single cases and ten-case lots to hover around $5.00 and $4.50 respectively. A prospective purchaser of ten cases, offered a price of $5.00, will shop for a competitor willing to sell at $4.50. At the same time, true competitors could not stay in business selling single cases at $4.50 if that price does not cover their costs.

In short, we need not worry about cost justification for differential pricing in competitive markets. When a competitor attempts to charge an unjustified higher price to a particular group of purchasers, the customers will find another supplier. Except for market fluctuations and imperfections, price differences in competitive markets generally reflect the different marginal costs of

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49. Prices on the New York Stock Exchange change hourly in ways that bear little relation to the marginal costs of the seller of the stock. For an illustration of the kind of sporadic price discrimination that exists in a healthy market, *see* R. POSNER, *supra* note 17, at 12-15.

50. *See* R. BORK, *supra* note 18, at 387-92.

51. O. Hommel Co. v. Ferro Corp., 659 F.2d 340, 346-47 (3d Cir. 1981), *cert. denied*, 102 S. Ct. 1711 (1982).

52. *Id.* at 347.

53. *Id.*

serving different classes of customers. When a seller lacks the requisite market power the differential prices it charges are non-discriminatory.

There are only two instances in which a seller without market power will attempt to employ discriminatory pricing. First, discriminatory pricing may be part of a scheme of partial vertical integeration. For example, a manufacturer could employ a dealer efficiency plan that effectively reduces the cost of goods for different dealers to differing degrees. Second, a dealer operating in two markets may engage in predatory pricing in only one market, thereby charging a lower price in that market than in the market that is not the target of its predation. Nevertheless, in the absence of market power it is implausible that either of these instances can operate to harm consumer welfare or the efficient allocation of resources in the market of a plaintiff bringing a secondary-line claim under the Robinson-Patman Act.

A. PRICE DISCRIMINATION AND PARTIAL VERTICAL INTEGRATION: THE CASE OF INCENTIVE PLANS

A firm that is fully integrated from top to bottom makes its own employment decisions, handles its own advertising, and generally oversees the performance of each retail outlet. Partially-integrated firms that do not own retail outlets must find other, less direct means of insuring that their outlets operate efficiently and serve the firm well. Recognizing this economic reality, the Supreme Court has applied a rule of reason analysis since 1977 to nonprice vertical restraints imposed by manufacturers upon their dealers.[54]

Dealer incentive programs are a manifestation of partial vertical integration that may be employed by a manufacturer with or without market power. Such programs enable a manufacturer to control distribution by rewarding successful dealers while penalizing unsuccessful ones.[55] The dealer incentive program at issue in *J. Truett Payne v. Chrysler Motors Corp.*[56] involved a sales quota established by Chrysler Motors for each of its retail auto dealers.[57] Chrysler paid its dealers a bonus on each car sold above the quota.[58] The bonus thereby effectively reduced the dealer cost of automobiles. Dealers that sold many cars in excess of their quota obtained from Chrysler a lower price per car than did dealers that sold only a few cars over their quota, or failed altogether to meet their quota. The plaintiff in *J. Truett Payne*, one of the disfavored dealers, claimed that this practice discriminated against its dealership and caused its economic failure, constituting secondary-line injury in violation of the Robin-

54. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58 (1977) (overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967)). For an analysis of the efficiency achievable by employing the type of partial vertical integration at issue in *Sylvania*, see Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171 (arguing in favor of rule of reason approach); Posner, *The Rule of Reason and the Sylvania Decision*, 45 U. CHI. L. REV. 1 (1977) (arguing that rule of reason approach yields unpredictable and inconsistent results); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution, Per Se Legality*, 48 U. CHI. L. REV. 6 (1981) (arguing in favor of per se legality).

55. For a general description and analysis of various dealer incentive plans, see Piraino, *The Legality of Distributor Incentive Discount Plans Under the Robinson-Patman Act*, 58 WASH. U. L. Q. 807 (1980).

56. 451 U.S. 557 (1981).

57. *Id.* at 564.

58. *Id.*

son-Patman Act.[59]

In *J. Truett Payne* the Supreme Court did not consider whether Chrysler's dealer incentive program involved true economic price discrimination. Presumably, it is more expensive for Chrysler to sell through inefficient dealers than through efficient ones. The differential pricing that resulted from the incentive program, therefore, may reflect only the differences in costs that Chrysler experienced with respect to different retail dealers. Under these circumstances the differential pricing would not represent true economic price discrimination, and should theoretically fall under the Robinson-Patman Act's cost-justification defense.[60] The difficulty in identifying true marginal costs for any particular transaction, however, weakens the defendant's ability to invoke this defense successfully.[61] Nevertheless, the program could not have operated to reduce output or cause consumer injury unless Chrysler possessed market power in the plaintiff's market.

A manufacturer with substantial market power could charge discriminatory prices to certain of its dealers as a mechanism for enlarging its profits by ensuring that the benefits of the market power accrue to the manufacturer rather than to the dealer. Assume, for example, that a manufacturer of automobiles has substantial market power in the retail market in Cleveland, but faces intense competition in Detroit. The marginal cost of manufacturing and selling a car is $5000, including dealer mark-up, and $5000 is the retail price in the competitive Detroit market. The same car would bring a profit-maximizing price of $5300 in Cleveland, where the manufacturer has market power. Assume that transportation costs between Detroit and Cleveland are greater than $300, so no arbitrage will occur. If the manufacturer sells at the same price to both the Cleveland and Detroit dealers, the Cleveland dealer will sell the automobile at $5300, and the benefits of the manufacturer's market power in Cleveland will accrue to the dealer. If the manufacturer can find a way to charge the Cleveland dealer $300 more per car, however, the benefits of the market power in Cleveland will accrue to the manufacturer. A fake dealer incentive program, weighted in favor of the Detroit dealer and against the Cleveland dealer, might have this effect.[62]

This scheme is implausible, however, if the manufacturer does not have market power in the geographic market where the disfavored dealer is located. The manufacturer in that case cannot use price discrimination to facilitate supra-marginal cost pricing in the disfavored dealer's area—indeed, such an attempt would be counterproductive. If the manufacturer does not have market power, disfavored purchasers who are asked to pay a price above marginal cost will simply seek a seller willing to provide the product at a competitive

59. *Id.* at 559-60.

60. *See supra* note 20 and accompanying text (discussing cost-justification defense of the Robinson-Patman Act).

61. *See supra* notes 21-24 and accompanying text (discussing weaknesses of the Robinson-Patman Act's cost-justification defense).

62. As a general rule the plaintiff (disfavored purchaser) alleging price discrimination under the Robinson-Patman Act must be able to show that it is in competition with one or more favored purchaser. *See* Collins Oil Co. v. Tenneco, Inc., 556 F.2d 1274, 1274 (5th Cir. 1977); Larry R. George Sales Co. v. Coal Attic Corp., 587 F.2d 266, 270-71 (5th Cir. 1979); *see also* Falls City Indus., Inc. v. Vanco Beverage, Inc., 51 U.S.L.W. 4275, 4277-78 n.7 (U.S. March 22, 1983).

price. This would result in a decrease rather than an increase in profits for both the manufacturer and the dealer. In the absence of market power, a dealer incentive program must be taken to mean what its name implies: a mechanism for encouraging dealer efficiency, not one enabling the manufacturer to reap monopoly profits.

The Supreme Court remanded in *J. Truett Payne*, instructing the Fifth Circuit to consider whether the dealer incentive plan caused "antitrust injury" to the plaintiff-dealer.[63] The Court required the plaintiff to show, under the docrine established in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,[64] that it suffered the kind of injury that the antitrust laws were designed to prevent.[65] According to *Brunswick*, antitrust injury arises from the anticompetitive effect of the violation itself or of anticompetitive acts made possible by the violation.[66] Price discrimination that results in the inefficient allocation of resources, therefore, may certainly constitute antitrust injury.[67] Nevertheless, the concept of antitrust injury remains ambiguous. In *J. Truett Payne* the Supreme Court suggested that the plaintiff should show that the alleged illegal price discrimination affected retail prices.[68] The Court's discussion suggests that antitrust injury is an injury that accrues to the plaintiff as the result of a practice that is likely to injure consumers as well.

The defendant's dealer-incentive program in *J. Truett Payne* was designed to encourage more sales of automobiles, and sales at lower prices. Although the program effectively gave some dealers lower prices than it gave others, and to that extent was more beneficial to some Chrysler dealers than others, in the absence of market power the program could not have operated either to reduce output or to damage consumer welfare. The Supreme Court, therefore, should have required a showing of the defendant's market power as a prerequisite to recovery.

B. PREDATORY PRICING AND SECONDARY-LINE INJURIES

Predatory pricing can be undertaken by a seller without market power and can result in economic price discrimination that is socially harmful.[69] The predatory seller sets prices below the competitive level to rid the market of competitors or to discipline them and enable the predator to obtain monopoly

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63. *J. Truett Payne*, 451 U.S. at 568.

64. 429 U.S. 477 (1977).

65. *J. Truett Payne*, 451 U.S. at 562.

66. *Brunswick*, 429 U.S. at 489. *See also* Independence Tube Corp. v. Copperweld Corp., 691 F.2d 310, 321-22 (7th Cir. 1982). *See generally*, Page, *Antitrust Damages and Economic Efficiency: An Approach to Antitrust Injury*, 47 U. CHI. L. REV. 467 (1980).

67. *See supra* notes 44-48 and accompanying text (discussing adverse effect of price discrimination on efficient allocation of resources).

68. *J. Truett Payne*, 451 U.S. at 564. In dismissing the complaint on remand, however, the Fifth Circuit did not address the Supreme Court's suggested concern with the effect of the alleged price discrimination on retail prices. *See* Chysler Credit Corp. v. J. Truett Payne Co., Inc., 670 F.2d 575 (5th Cir. 1982).

69. The law of predatory pricing has generated a vast body of literature. For a survey of ideas presented in the literature, *see* Hurwitz & Kovacic, *Judicial Analysis of Predation: The Emerging Trends*, 35 VAND. L. REV. 63, 66-83 (1982); Brodley & Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards*, 66 CORNELL L. REV. 738 (1981).

prices in the same market in the future.[70] To engage in predatory pricing the seller needs only an ability to outlast its rivals. The seller engaged in predatory pricing may not have market power in the targeted market, but instead hopes to acquire market power by driving out or disciplining its rivals.[71]

Although consumers in the market subject to predation are the long-range victims, competitors of the seller in that market are unquestionably the immediate victims.[72] Consequently, predatory pricing is generally the subject of lawsuits brought by competitors of the predator, most often alleging attempted monopolization under section 2 of the Sherman Act.[73]

When the predation includes price discrimination—that is, selling at a predatory price in one geographic market, but at a nonpredatory price in other markets—it also falls within the Robinson-Patman Act.[74] Lawsuits under the Robinson-Patman Act to challenge predation are also generally brought by the defendant's competitors, as primary-line cases.[75] A secondary-line Robinson-

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70. *See* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1031-32 (9th Cir. 1981), *cert. denied*, 103 S. Ct. 57 (1982); *see also* 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 711b (1978) (classic predation case involves deliberate sacrifice of present revenues for purpose of driving out rivals and recouping losses through higher profits).

71. One general exception to this is a situation involving a "predatory" price above average total cost. *See* Transamerica Computer Co., Inc. v. IBM, 698 F.2d 1377,1386-88 (9th Cir. 1983).

72. Some commentators maintain that, because bona fide instances of predatory pricing are rare and the threat of overdeterrence is great, actions for predatory pricing ought to be limited to consumers in the market subject to predation that will be charged a higher price when the predator has accomplished its task. *See* Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 331 (1981); *see also* Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284, 289 (1977) (predatory pricing rule designed to encourage competition may sometimes injure consumers by encouraging inefficiency).

73. 15 U.S.C. §§ 1-7 (1976). *See, e.g.*, William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1024-25 (9th Cir. 1981), *cert. denied*, 103 S. Ct. 57 (1982); Northeastern Tel. Co. v. American Tel. & Tel. Co., 651 F.2d 76, 79-82 (2d Cir. 1981), *cert. denied*, 102 S. Ct. 1438 (1982).

74. 15 U.S.C. § 13(a) (1976).

75. *See, e.g.*, Utah Pie v. Continental Baking Co., 386 U.S. 685, 689-90 (1967); William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1039-50 (9th Cir. 1981), *cert. denied*, 103 S. Ct. 57 (1982); International Air Industries, Inc. v. American Excelsior Co., 517 F.2d 714, 721 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). *See also supra* note 2 (defining primary-line Robinson-Patman cases).

The emerging judicial trend treats predatory pricing in primary-line Robinson-Patman Act cases in the same way as it is treated under section 2 of the Sherman Act. *See* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1041 (9th Cir. 1981) (Sherman Act principles equally applicable in primary-line Robinson-Patman Act suit), *cert. denied*, 103 S. Ct. 57 (1982); O. Hommel Co. v. Ferro Corp., 659 F.2d 340, 348 (3d Cir. 1981) (Robinson-Patman Act concept of predation does not differ from Sherman Act concept), *cert. denied*, 102 S. Ct. 1711 (1982); Pacific Engineering & Prod. Co. v. Kerr-McGee Corp., 551 F.2d 790, 798 (10th Cir.) (facts which do not establish predatory pricing in violation of Sherman Act should be interpreted no differently under the Robinson-Patman Act), *cert. denied*, 434 U.S. 879 (1977); *see also* P. AREEDA & D. TURNER, ANTITRUST LAW, ¶ 720c (Supp. 1982) (some courts find primary-line Robinson-Patman injury implicates same concerns as predatory pricing under Sherman Act)

In *Inglis*, for example, the Ninth Circuit applied, with some variations, the Areeda-Turner test for predatory pricing to claims arising under both section 2 of the Sherman Act and the Robinson-Patman Act. 668 F.2d at 1035-36. Under the Areeda-Turner test, a price above the reasonably anticipated average variable cost is presumptively legal and one below average variable cost is illegal. *See* P. AREEDA & D. TURNER, *supra*, at ¶ 711d.

The logical conclusion of this analysis, as Professor Areeda suggests, is that the Robinson-Patman Act is superfluous in predatory pricing cases—it does no more than section 2 of the Sherman Act does. *See* P. AREEDA & D. TURNER, *supra*, at ¶ 720c. Moreover, because the Robinson-Patman Act contains a host of limitations on subject-matter jurisdiction that the Sherman Act does not contain, the Robinson-Patman Act is effectively much narrower than the Sherman Act. For a survey of these complex limitations, *see generally*, F. ROWE, *supra* note 5, 45-85.

Patman Act lawsuit could also be brought by customers in the high-priced market, however, under the recoupment theory of predatory pricing.[76] Under this theory a seller operating in two markets, with monopoly power in only one, engages in predatory pricing in the competitive market and finances its predation by raising its price in the monopoly market. A buyer in the market that is not the target of the predation would have a secondary-line cause of action under the Robinson-Patman Act for the higher, discriminatory price charged to finance the predation.[77]

The flaw in the recoupment theory, of course, is that the seller would already be charging its profit-maximizing price in the market that is not the locus of the predatory activity. If it raises its prices in the monopoly market, it will produce less, not more revenue. Only one situation exists in which the recoupment theory may have merit. This situation arises when the seller previously refrained from charging its profit-maximizing price in the noncompetitive market, fearing Robinson-Patman liability, but later decides to risk liability by charging predatory prices in a competitive market and raising prices to their profit-maximizing level in another market to finance its predation.

Assume that a seller, operating in two markets, has market power in one market and an aggressive rival in the other. The seller's marginal costs of producing and delivering widgets is $1.00 in both markets. The price of wid-

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76. The recoupment theory was popular when the Robinson-Patman Act was passed. *See* JUSTICE DEP'T REPORT, *supra* note 5, at 124-25. The Supreme Court recognized the recoupment theory in Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954), a primary-line case. The Court warned against the potential for interstate firms to finance local predatory pricing with profits from sales in other markets. *See id.* at 119.

More recently, the Third Circuit has discussed the recoupment theory in describing potentially discriminatory practices. *See* O. Hommel Co. v. Ferro Corp., 659 F2d 340, 350 (3d Cir. 1981), *cert. denied*, 102 S. Ct. 1711 (1982). In the legislative history of original section 2 of the Clayton Act, Congress expressed its concern about the potential use of market power to recoup loses incurred through predatory pricing. *See* S. REP. NO. 698, 63d Cong., 2d Sess. 3 (1914) ("Every concern that engages in this evil practice [price cutting intended to destroy competition] must of necessity recoup its losses in the particular communities or sections where their commodities are sold below cost or without a fair profit by raising the price of this same class of commodities above their fair market value in other sections or communities"); *see also* H.R. REP. NO. 627, 63d Cong., 2d Sess. 8 (1914) (Clayton Act intended to prevent powerful national corporations from attempting to establish monopoly by lowering prices in markets where competition exists).

77. The general effect of the Robinson-Patman Act is to force the seller to offer its product at the same price in both markets. *See* Bowman, *Restraint of Trade by the Supreme Court: The Utah Pie Case*, 77 YALE L. J. 70, 74 (1967).

Primary-line application of the Robinson-Patman Act is just as likely to be anti-competitive as pro-competitive. On the one hand, the Robinson-Patman Act may force the seller to charge less than its profit-maximizing price in its monopoly market because it could do so only by foregoing many sales in the competitive market or by exiting the competitive market altogether. The Act also may make predatory pricing more expensive. For example, if the seller decides to sell widgets in the competitive market at a predatory price to drive a rival out of business, it must also lower its prices in other markets.

On the other hand, the Robinson-Patman Act prevents the seller from competing aggressively in each of its separate markets. If it sells at a monopoly price in one market, the high rate of return it achieves there might discourage it from competing in a second market because it can do so only by cutting prices in the monopoly market. Many economists believe that the primary-line application of the Robinson-Patman Act operates more effectively to prevent competitive pricing than predatory or monopoly pricing. *See* R. POSNER, *supra* note 17, at 38 (only effect of statute is prohibition of innocent competitive behavior); JUSTICE DEP'T REPORT, *supra* note 5, at 169 ("[t]he more the statute is enforced and . . . complied with, the greater becomes its harmful effects on competition"); Bowman, *supra* at 70 (Supreme Court used statute to undermine price competition); Hovenkamp, *Judicial Reconstruction of the Robinson-Patman Act: Predatory Differential Pricing*, 7 U.C. DAVIS L. REV. — (1983) (forthcoming).

gets in the competitive market is $1.00. The seller has sufficient market power in the noncompetitive market to charge a profit-maximizing price of $1.25. Because of the Robinson-Patman Act, however, the seller has been charging only $1.00 in both markets. When the seller decides to risk Robinson-Patman liability, it drops the price in the competitive market to a predatory level of 80¢ in an effort to drive its competitors out of business. It finances that predation by raising its prices in the noncompetitive market to the profit-maximizing level of $1.25.

If this occurs, the seller's customers in the nonpredated market are injured. They are being charged a higher price to finance the seller's predatory pricing in another market. The scheme is plausible, however, only if the seller has market power in the market where the allegedly injured customers are located. If the seller is a competitor in that market, engaged in marginal-cost pricing, it would not be able to raise its prices to the higher, profit-maximizing level, in order to finance predation elsewhere.

Predatory pricing is the only explanation for systematic economic price discrimination by a seller without market power. For that reason, market power is not an essential element of a primary-line Robinson-Patman lawsuit brought by a competitor alleging predatory pricing. In a secondary-line action brought by a customer in an allegedly disfavored market, however, the plaintiff should be required to prove that the defendant has market power in the plaintiff's market in order to establish a relationship between its own alleged injury and the defendant's predatory pricing in another market. If the defendant engages in predatory pricing in another market without altering its price in the plaintiff's market, the plaintiff is not injured by the predatory activity.[78]

IV. MARKET POWER AND THE COST-JUSTIFICATION DEFENSE

A market power requirement in secondary-line price discrimination cases would not undermine or obviate the cost-justification defense.[79] Although market power is a prerequisite to the price discrimination that presents antitrust problems in secondary-line cases, it does not follow that all defendants with market power engage in illegal price discrimination, any more than that all defendants with market power violate the monopolization provisions of the Sherman Act.[80] After a plaintiff makes out a prima facie case of secondary-line price discrimination—a case that includes the defendant's possession of market

78. The plaintiff might allege injury resulting from a diversion of its business rather than from increased prices, because of the defendant's predatory pricing in another market. *Cf.* Balian Ice Cream v. Arden Farms Co., 231 F.2d 356, 367 (9th Cir. 1955) (court found no diversion in primary-line case). Indeed, the theory is based on the premise that the targeted low-price market and the plaintiff's market are not really separate markets. This makes the theory that the defendant is pricing predatorily in the low-priced market implausible. Price discrimination within a single geographic market will not serve as the basis for predatory pricing because disfavored purchasers themselves will insist on the lower price, and the predator will ultimately be forced to sell to everyone at the same, predatory price. *See* O. Hommel Co. v. Ferro Corp., 659 F.2d 340, 348-49 (3d Cir. 1981), *cert. denied*, 102 S. Ct. 1711 (1982).

79. 15 U.S.C. § 13(a) (1976). *See supra* note 20 and accompanying text (discusing cost-justification defense).

80. *See* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 281 (2d Cir. 1979) (camera manufacturer with monopoly power that fails to inform competitors of plans to introduce new film and camera not in violation of Sherman Act), *cert. denied*, 444 U.S. 1093 (1980).

power—the defendant must still be permitted to demonstrate that its price differences do not constitute true economic price discrimination at all, but rather reflect the varying marginal or average variable costs of serving different classes of customers. In short, market power makes socially injurious price discrimination plausible; it does not make price discrimination necessary, and differential pricing may still be non-discriminatory.

CONCLUSION

Many instances of differential pricing that arise under the Robinson-Patman Act are cost-justified; that is, they are not discriminatory at all. No theory exists under which such cost-justified price differences can injure consumer welfare. On the contrary, consumer welfare is maximized when each consumer pays the marginal cost of production and delivery of its own purchases.

Some instances of true economic price discrimination may even benefit consumers. When differential pricing reflects the normal give and take of the market or when it facilitates the break-up of a cartel or oligopoly, consumers are not injured, and are likely to benefit.

Price discrimination is harmful to plaintiffs bringing a secondary-line action under the Robinson-Patman Act only when undertaken by a seller to obtain supra-competitive profits from high-preference customers or to support predatory pricing. In both instances, the intended result requires that the seller have sufficient market power to implement and sustain the discriminatory pricing. Therefore, a plaintiff-customer in the disfavored market should be required to prove that the defendant has market power in the plaintiff's market as a prima facie element of its secondary-line Robinson-Patman Act case.

Imposition of a market power requirement does not undermine the basic structure of the Robinson-Patman Act. It does not, for example, make superfluous the cost-justification defense. Although market power is a prerequisite for the kind of price discrimination envisioned within the framework of secondary-line cases, not all defendants with market power that charge different prices are engaged in illegal price discrimination. Rather, the issue of market power goes to the basic prima facie case that a plaintiff must make. The plaintiff at the very least must show that the price discrimination and antitrust injury are plausible, and they are plausible only if the defendant has market power in the plaintiff's market.

NOTE

The Shetar's Effect on English Law—A Law of the Jews Becomes the Law of the Land

> The rational study of law is still to a large extent the study of history.
> Holmes, *The Path of the Law*.[1]

I. Introduction

English law, like the English language, is an amalgam of diverse cultural influences. The legal system may fairly be seen as a composite of discrete elements from disparate sources. After the conquest of 1066, the Normans imposed on the English an efficiently organized social system that crowded out many Anglo-Saxon traditions.[2] The Jews, whom the Normans brought to England,[3] in their turn contributed to the changing English society. The Jews brought a refined system of commercial law: their own form of commerce and a system of rules to facilitate and govern it. These rules made their way into the developing structure of English law.

Several elements of historical Jewish legal practice have been integrated into the English legal system.[4] Notable among these is the written credit agreement—shetar, or starr, as it appears in English documents. The basis of the shetar, or "Jewish Gage," was a lien on all property (including realty)[5] that has been traced as a source of the modern mortgage.[6] Under Jewish law, the shetar

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1. 10 Harv. L. Rev. 457, 469 (1897).

2. 1 G.M. Trevelyan, History of England 142-48 (1953).

3. 1 F. Pollock & F.W. Maitland, The History of English Law Before the Time of Edward I 468 (reissued 2d ed. 1968). There is some dispute whether the Jews arrived by William the Conqueror's invitation or merely with his permission. 4 S. Baron, A Social and Religious History of the Jews 77 (1957).

4. *See generally* J. Rabinowitz, Jewish Law 250-72 (1956) (discussing Jewish Gage, Odaita, Starr of Acquittance, and Representation by Attorney).

5. *See infra* text accompanying notes 34-36 (describing shetar and accompanying lien).

6. Rabinowitz, *The Common Law Mortgage and the Conditional Bond*, 92 U. Pa. L. Rev. 179-94 (1943). The author traces the two-instrument (debt and release) mortgage to its origin as a device to avoid asmakhta, a Jewish principle invalidating penalty clauses. Under that doctrine, Jewish money lenders were forbidden to exact a penalty conditioned on the future failure of the debtor's obligation. *Id.* at 184-85. If a conveyance involved asmakhta, it was void. *Id.* at 182. Invalidation as asmakhta could be avoided if all obligations were incurred at the time of the original transaction. *Id.* at 184, 185-86. Land was seizable as security only if the creditor went into possession at the time of the loan: "Meakhshav"—"from now". *Id.* at 185. For this reason, the debt instrument included an immediate conveyance of the land that was to serve as security against default. A second instrument, the acquittal, would release the security and reconvey the land to its original owner if the debt were paid on or before its due date. *Id.* at 185. The entire written obligation (shetar) remained in the hands of a third party for the duration of the debt. *Id.* at 192. The document proved that the debt existed and clarified the rights and duties of the parties in case of default. *See also* 2 C. Herzog, The Main Institutions of Jewish Law 71-92 (2d ed. 1967) (chapter on asmakhta).

Rabinowitz finds in these and other early Jewish devices for avoiding asmakhta both the structural and substantive roots of the English mortgage and the later developed equitable right of redemption. J. Rabinowitz, *supra* note 4, at 250-72. *See also* F. Lincoln, The Starra 47-50 (1939) (outlining the same derivation); *see generally* F. Lincoln, The Legal Background to the Starra (1932) (same). Compare the historical period of equitable right of redemption with the same term of protected re-

permitted a creditor to proceed against all the goods and land of the defaulting debtor.[7] Both "movable and immovable" property were subject to distraint.[8]

In contrast, the obligation of knight service under Anglo-Norman law barred a land transfer that would have imposed a new tenant (and therefore a different knight owing service) upon the lord.[9] The dominance of personal feudal loyalties equally forbade the attachment of land in satisfaction of a debt; only the debtor's chattels could be seized.[10] These rules kept feudal obligations intact, assuring that the lord would continue to be served by his own knights. When incorporated into English practice, the notion from Jewish law that debts could be recovered against a loan secured by "all property, movable and immovable" was a weapon of socio-economic change that tore the fabric of feudal society and established the power of liquid wealth in place of land holding.[11]

The Crusades of the twelfth century opened an era of change in feudal England. To obtain funds from Jews, nobles offered their land as collateral.[12] Although the Jews, as aliens, could not hold land in fee simple,[13] they could take security interests of substantial money value.[14] That Jews were permitted to hold security interests in land they did not occupy expanded interests in land beyond the traditional tenancies.[15] The separation of possessory interest from interest in fee contributed to the decline of the rigid feudal land tenure structure.[16]

At the same time, the strength of the feudal system's inherent resistance to this widespread innovation abated. By 1250, scutage[17] had completely replaced feudal services: tenant obligations had been reduced to money pay-

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demption in *Leviticus* 25:29: "And if a man sell a dwelling house in a walled city; then he may redeem it within a whole year after it is sold; for a full year shall he have the right of redemption." *Id.*

7. J. RABINOWITZ, *supra* note 4, at 253. *See infra* text accompanying notes 33-47 (describing shetar in Jewish law).

8. *See infra* text accompanying note 35 (extent of lien imposed by shetar).

9. T.F. BERGIN & P.G. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 8 (1966). Land tenure was central to social organization within the feudal system:

> The feudal system originated in the relations of a military chieftain and his followers, or king and nobles, or lord and vassals, and especially their relations as determined by the bond established by a grant of *land* from the former to the latter. From this it grew into a complete and intricate complex of rules for the tenure and transmission of real estate, and of correlated duties and services . . . .

BLACK'S LAW DICTIONARY 560 (rev. 5th ed. 1979) (emphasis in original).

10. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 596.

11. *See* H.G. RICHARDSON, THE ENGLISH JEWRY UNDER ANGEVIN KINGS 94 (1960) (Jews' liquidation of land obligations broke down rigidity of structure of feudal land tenure and facilitated transfer of land to new capitalist class).

12. E. JENKS, EDWARD PLANTAGENET, THE ENGLISH JUSTINIAN 40-41 (1923).

13. *See* F. LINCOLN, THE STARRA 114-15 (1939) (Jews could possess lands, but not hold by fee); SELECT PLEAS, STARRS, AND OTHER RECORDS FROM THE ROLLS OF THE EXCHEQUER OF THE JEWS ix-x (J.M. Rigg ed. & trans. 1902) [hereinafter J.M. RIGG] (Jews religiously barred from swearing Christian oath of fealty, and therefore disabled from holding feudal estate).

14. E. JENKS, *supra* note 12, at 40-41.

15. *Cf.* 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 469 (alien to English law for creditor not in possession of land to have rights in it).

16. E. JENKS, *supra* note 12, at 41.

17. Scutage, in medieval feudal law, was a payment by the tenant in lieu of military service. D. WALKER, THE OXFORD COMPANION TO LAW 1121 (1980). *See infra* note 18.

ments.[18] And as the identity of the principals in the landlord-tenant relationship became less critical, a change in the feudal rules restricting alienability of interests in land became possible.

One catalyst for this change may have been the litigation surrounding debt obligations to Jews secured by debtors' property. The Jews in Norman England had a specified legal status. They alone could lend money at interest.[19] They were owned by the King, and their property was his property.[20] The King suffered their presence only so long as they served his interests[21]—primarily as a source of liquid capital.[22]

Because moneylending by Christians was infrequent, English law had not established its own forms of security.[23] The Jews operated within the framework of their own legal practice,[24] which was based on Talmudic law developed over centuries of study. But the peculiar status of the Jews as the Crown's de facto investment bankers encouraged the King to direct his courts to enforce the credit agreements made by Jews under their alien practice. This nourished the growth of Jewish law in a way that blurred the absolutes of feudal land tenure.[25] Previously inalienable rights in land gave way to economic necessities, and the English ultimately adopted the Jewish practices.[26]

This note examines a moment of contact between two peoples, when necessity, proximity, and social upheaval prompted a cultural exchange between the Jewish merchants and moneylenders and those they served. The note describes the effect on English law brought about by the King's Jews as they

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18. In feudal land holding, the tenant's possessory right in land was limited to usufruct, as granted by the King, who retained absolute dominion over the land. The denotation of the tenant's interest as *fee* (or *fief*, *feud*, or *feodum*) reflected the tenant's obligation to render service to the sovereign in return for the privilege of using the land. 2 W. BLACKSTONE, COMMENTARIES *104-05.

During the first century of the Norman Conquest land was held by military tenure, in which the tenants owed a specified number of days per year in knight service. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 252. Either the tenants or their servants owed personal service in the King's army. Later, the King came to require a standing army to pursue extended campaigns on the Continent. *Id.* In place of short-term combat service, the King accepted "scutage" (literal derivation: "shieldage"), whereby his tenants-in-chief sent money in lieu of themselves or their knights. *Id.* at 266. The scutage fees enabled the King to employ professional troops and permitted the gentlemen to remain at home. *Id. See generally id.* at 252-82 (section on knight's service). By the reign of Edward I in 1272, both personal service and scutage failed to provide adequate military resources; additional taxes were instituted in their stead. E. JENKS, *supra* note 12, at 102.

19. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 468.

20. *Id.* at 468, 471.

21. *See* Mandatum Regis Justiciariis Ad Custodiam Judeorum Assignatis de Quibusdam Statutis per Judeos in Anglia Firmiter Observandis. Anno Regni Regis Henrici Tricesimo Septimo (Mandate of the King to the Justices Assigned to the Custody of the Jews Touching Certain Statutes Relating to the Jews in England Which are to Be Rigorously Observed. The Thirty-Seventh Year of King Henry) [A.D. 1253] (Mandate of Henry III ordaining "[t]hat no Jew remain in England unless he do the King service, and that from the hour of birth every Jew, whether male or female, serve Us in some way"), *printed in* J.M. RIGG, *supra* note 13, at xlviii-xlix.

22. 1 G.M. TREVELYAN, *supra* note 2, at 250-51.

23. J. RABINOWITZ, *supra* note 4, at 262.

24. *See* J.M. RIGG, *supra* note 13, at xix (Jews made loan arrangements according to traditional law of the shetar).

25. *See* 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 123-24 (Jewish creditors' rights in land enforced by King; same rights not available originally to Christian creditors).

26. *See* 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 475 (Second Statutes of Westminster of 1285 gave Christian creditor the remedy of *elegit*, similar to the choice of remedies afforded Jewish creditors). *See also infra* text accompanying notes 168-78 (Statute of Merchants adopted enrollment procedures and eventual award of land to unpaid creditor).

executed and registered debt instruments, assigned and enforced the underlying obligations, and generally survived by moneylending, the only profitable occupation open to them.[27] It first reviews the Jewish credit agreement and its function in Anglo-Norman feudal society. It then suggests a rational explanation for a development in medieval English law heretofore perceived only as an anomaly: that the early writs of debt, which were for recovery of money, used terminology more appropriate to an action for recovery of land. This confusion now appears to be merely the linguistic expression of an innovation in the law due to the development of an action to recover alternative relief: repayment of money lent or award of collateralized land.

Finally, the note focuses on the incorporation of Jewish law into English practice through a series of thirteenth century cases involving the same Jewish litigant. Jewish debt procedure had by then become part of everyday business in England. Even as the Jews began to be excluded from moneylending, their procedures were adopted into the general English law governing debt registration and collection. In 1275, the statute "De Judeismo"[28] forbade the Jews' usurious practices.[29] In 1285, the Statute of Merchants[30] formalized creditor remedies that paralleled the provisions of the Jewish shetar.[31] In 1290, the Jews were expelled,[32] but their credit practices remained.

II. JEWISH CREDIT AGREEMENTS IN FEUDAL ENGLAND

A. THE SHETAR IN JEWISH LAW

The law of the shetar, developed and elaborated by 500 A.D. in the Babylonian Talmud, antedates the Norman Conquest by six centuries.[33] Historically, the "shetar hov" (or generally just "shetar") was an instrument that established formal obligation, either in contract or in debt.[34] At the moment that a debtor acknowledged his indebtedness through a shetar, a general lien was established, encumbering *all* the debtor's property as security for ultimate repayment.[35] In case of default, the creditor could proceed not only against movable

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27. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 471 (English Jews could profitably engage only in moneylending). Although the Talmud prohibited charging interest on loans, even to Gentiles, authorities including Rabbenu Tam (a 12th-century Talmud scholar whose opinions are still cited with respect) permitted Jews to lend Gentiles money at interest "because no other avenues of trade or commerce [were] open to Jews, and the lending of money [was] the only means of livelihood left to them." D.M. SHOHET, THE JEWISH COURT IN THE MIDDLE AGES 89-90 (1931).

28. 1 STATUTES OF THE REALM 221 (London 1810 & photo. reprint 1963). This statute, which is undated, is generally thought to date from 1275. *See* 10 S. BARON, *supra* note 3, at 111 (attributing statute to 1275); J.M. RIGG, *supra* note 13, at xxxviii (attributing statute to 1274-75). STATUTES OF THE REALM attributes the statute to either 4 Edw. (1275-76) or 18 Edw. (1289-90). 1 STATUTES OF THE REALM 221 n.[1].

29. *See* Les Estatutz de la Jeuerie (The Statutes of Jewry) ¶ 1 STATUTES OF THE REALM 221, 221 (providing that henceforth no Jew lend at usury upon land, rent, or other thing; that interest accruing after previous Feast of St. Edward not be collectible; that debts to Jews secured by chattels be paid by Easter or be forfeited; and that the King will no longer enforce the Jews' usurious contracts, but will punish the lender).

30. Statute of Merchants, 1285, 13 Edw., Stat. 3.

31. *See infra* text accompanying notes 168-78.

32. 10 S. BARON, *supra* note 3, at 113.

33. G. HOROWITZ, THE SPIRIT OF JEWISH LAW 16 (1953).

34. Fuss, *Shetar*, in PRINCIPLES OF JEWISH LAW 186 (M. Elon ed. 1975).

35. *Id.* The shetar imposed a lien on all the real property that the debtor owned at the time of the

and immovable property held by the debtor, but also against encumbered land that the debtor had transferred to a third party.[36] The debt attached to the land, and the creditor's lien had priority over subsequent alienations.[37]

Because of the severe obligations imposed by the shetar, the contents of the instrument followed a standard form designed to ensure authenticity and precision. Each shetar recited standard clauses of obligation, the creditor's right to customary modes of execution, and a final phrase stating that the document was not merely a form but a statement of an express contract.[38] Inserted into the form language were the names of the parties, the sum and the currency of the debt, and the date of the obligation, thereby indicating the creation of the lien.[39] To prevent fraud, the document was signed by two witnesses who knew the parties.[40]

A nation of wanderers, in adapting to a variety of cultures, determined that the language in which the shetar was written should be irrelevant to its legal validity.[41] Thus, in dealings with a surrounding Gentile populace, Jews were content that loan agreements be formalized in Latin or in the Norman French of early England.[42] Generally, the Jewish parties and witnesses would attest in

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instrument's formation, regardless of whether the lien was expressly written into the shetar. Jewish law originally did not attach debt obligation to chattels. During the amoraic period, Jewish law extended the lien to the movable property of the debtor if specifically noted in the shetar. But the rabbinic courts would not enforce a lien against movable property that had been sold by the debtor to a third party. *Id.*

36. *Id.* at 186. During the post-Talmudic period, it became customary to insert in the shetar a provision imposing a lien on the debtor's after-acquired property. J. RABINOWITZ, *supra* note 4, at 254.

37. Elon, *Lien*, in PRINCIPLES OF JEWISH LAW 288 (M. Elon ed. 1975).

38. Fuss, *supra* note 34, at 184-85; G. HOROWITZ, *supra* note 33, at 509-11.

39. G. HOROWITZ, *supra* note 33, at 511.

40. *Id.* at 511. In contrast to the documentary procedure of the written shetar, credit agreements also could be made orally under Jewish law. Milveh be-al peh—literally "loan by mouth" was distinguished from milveh bi shetar—"loan by writing." Shiloh, *Loans*, in PRINCIPLES OF JEWISH LAW 262 (M. Elon ed. 1975). The oral creditor, however, had no right to levy on the debtor's alienated and encumbered property to obtain satisfaction of the debt. *Id.*

41. 1 C. HERZOG, THE MAIN INSTITUTIONS OF JEWISH LAW 152 (2d ed. 1965).

From the time of the Jewish exile in Babylonia, 586 B.C., the Jews had lived as outsiders in foreign lands. In order to live within their own law, they developed a doctrine to minimize conflicts between Jewish law and the law of the surrounding community. G. HOROWITZ, *supra* note 33, at 79. In dealings with the Christian populace, the Jewish community followed the principle that "the law of the Kingdom is the Law" (dina de-malkhuta dina). They accepted and obeyed any law that did not conflict with Jewish laws governing specific religious obligations. *Dina De-Malkhuta Dina*, in 6 ENCYCLOPEDIA JUDAICA 51, 54 (1972). Respect for the rule of the Gentile sovereign raised the problem of determining the applicable law:

> The decrees of the king are law to us; but the national law is not our law. Among all nations there are certain fundamental rights and privileges which belong to the sovereign. Within this scope, the commands of the king are law. But this does not hold true of the judgments rendered in their courts. For the laws which the courts apply are not the essence of royalty. They are based on the precedents to be found in their writings. You cannot dispute this distinction, for otherwise you would annul, God forbid, the laws of the Jews.

G. HOROWITZ, *supra*, at 79-80 (quoting Rashba, Rabbi Solomon ibn Adret of Barcelona (1235-1310)).

Jewish courts would enforce external civil laws and formalities, *id.* at 80, but did not permit such civil law to sanction behavior otherwise forbidden to Jews. *Id.* Thus, a transaction enforceable in Gentile courts might still be invalidated (as applied to Jews) by a Jewish tribunal. *Id.* at 80-81.

42. J.M. RIGG, *supra* note 13, at xix. *See* HEBREW DEEDS OF ENGLISH JEWS (M.D. Davis ed. & trans. 1888) [hereinafter M.D. DAVIS] (reproducing the Hebrew portion of shetars in Hebrew and Latin); STARRS AND JEWISH CHARTERS PRESERVED IN THE BRITISH MUSEUM (I. Abrahams, H.P. Stokes & H. Loewe eds. & trans. 1930-32) [hereinafter STARRS AND CHARTERS] (reproducing Hebrew and Latin portions of shetars).

Hebrew and the Christians in French or Latin.[43] Although neither party may have understood the other's language, the document had the full force of law in both communities.[44]

The crucial limitation on debt collection under Jewish law was that a creditor had a lien against the debtor's land, but not against the debtor's person.[45] Personal freedom was not to be diminished by a debt obligation, and a creditor could not enslave one who was unable to repay him.[46] The origin of this practice was the Biblical protection of the dignity of debtors, as embodied in the injunction not to enter the debtor's home to receive a pledge, but rather to wait outside for the debtor to bring it out.[47] This was the structure of the law of obligation that the Jews brought with them to England.

B. NORMANS IN ENGLAND—A CENTRALIZING MONARCHY

Unique among its feudal neighbors, the Norman Duchy was governed as a centralized unit, with no baron strong enough to challenge the Duke's authority.[48] Although the Norman Duke owed fealty to the King of France, that King lacked effective power over his vassals, who independently governed their own territories.[49] In Normandy, however, feudalism was strictly territorial: a pyramid of land tenure embodied a system of military obligations ascending from knight through baron to Duke, from whom all land and authority derived.[50] On the continent, and later in England, William the Conqueror set out to maintain and strengthen this Norman system of centralized governance.[51] With the Conquest, the Normans introduced to England a well-organized central authority.[52]

The early governance of conquered England concentrated power in the King. As William the Conqueror imposed the rigorous order of the feudal

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43. *See, e.g.,* J.M. RIGG, *supra* note 13, at xix (Hebrew creditor signed in Hebrew); *id.* at 46 (record of Exchequer documenting shetar written in Hebrew with Latin duplicate). In England the terms of the acquittance took the Jewish form of the release: "from the beginning of the world" to the present. J. RABINOWITZ, *supra* note 4, at 265-69.

44. Both Jewish and English courts recognized the force of a shetar offered as evidence of a debt. J.M. RIGG, *supra* note 13, at xix-xx. Rigg describes the elaborate recording and witnessing procedures, including both Jewish and Gentile participants, designed to avoid fraudulent documents. *Id.* The King's courts enforced a duly enrolled shetar. *See infra* text accompanying notes 132-48 (discussing mechanism by which Exchequer enforced debt obligations). The courts within the Jewish community routinely enforced shetars.

45. Elon, *Imprisonment for Debt*, in PRINCIPLES OF JEWISH LAW 634 (M. Elon ed. 1975).

46. *Id.* at 634. *See also* M. ELON, RESTRAINTS OF THE PERSON AS A MEANS IN THE COLLECTION OF DEBTS IN JEWISH LAW (1961) (precis of doctoral dissertation) (Jewish tradition had no personal imprisonment for debt, reasoning that if a debtor's home could not be entered, even less could the debtor be taken; in the 13th century, Jewish scholars began to debate and approve imprisonment for evasive debtors, but only in carefully prescribed conditions).

Unlike Jewish law, English law specifically envisioned such imprisonment. *See* Statute of Merchants, 1285, 13 Edw., Stat. 3 (establishing imprisonment of the body of a defaulting debtor); Statute of Acton Burnell, 1283, 11 Edw. (if debtor's goods insufficient to satisfy debt, debtor imprisoned pending repayment, but creditor responsible for assuring bread and water sufficient to sustain life of imprisoned debtor, who must further reimburse creditor upon release).

47. *Deuteronomy* 24:10-11 (to preserve debtor's dignity in his own home).

48. 1 G.M. TREVELYAN, *supra* note 2, at 144.

49. *Id.* at 144-45.

50. *Id.* at 143.

51. W. STUBBS, THE CONSTITUTIONAL HISTORY OF ENGLAND 74-75 (abr. ed. 1979).

52. G.M. TREVELYAN, *supra* note 2, at 142.

system, he avoided the system's tendency toward decentralization and disintegration that had sapped the power of the French kings.[53] He limited the power of his tenants-in-chief by granting each of them landholdings scattered over the realm, instead of large, contiguous tracts.[54] He governed the counties through sheriffs who depended on him for their power.[55] He maintained a national militia, thereby shunning total reliance on the loyalty of his tenants-in-chief.[56] And he had all significant landholders swear an oath of primary allegiance to him.[57] This concentration of power in the monarch grew during the successive reigns of a series of strong kings who increasingly assumed more power—military, legislative, and judicial—over the nation.[58]

C. THE JEWS UNDER THE NORMAN KINGS

Outsiders in feudal society, both Anglo-Norman and continental, the Jews were not part of the network of land-based obligations. They could not own land. On the Continent, they were owned as chattels by the local lords, who protected the Jews' possessions on the understanding that what a Jew owned, he held for the ultimate use of his lord.[59] The Jews in Norman England, however, were within the exclusive domain of the King's personal control, living at his sufferance and according to his wishes.[60]

The first settlement of Jews in England came in the wake of William the Conqueror.[61] William determined that he should be the sole owner of Jews in England. Others could own Jews only with the King's permission as expressed by royal grant.[62] The *Leges Edwardi Confessoris*, a twelfth-century compilation and translation into Latin of laws attributed to Edward the Confessor,[63]

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53. W. STUBBS, *supra* note 51, at 85-91.
54. *Id.* at 90-91.
55. *Id.* at 88.
56. *Id.* at 86.
57. *Id.* at 84.
58. *Id.* at 117-18. The dates of the Norman and Angevin Kings from the Conquest to the expulsion of the Jews in 1290 are:

William I	1066-1087
William II	1087-1100
Henry I	1100-1135
Stephen	1135-1154
Henry II	1154-1189
Richard I	1189-1199
John	1199-1216
Henry III	1216-1272
Edward I	1272-1307

D. WALKER, *supra* note 17, at 1317.
59. F. LINCOLN, *supra* note 13, at 8-9. As "Administrator of the Realm," the continental King had interstitial power in the areas where no vassal could substantiate a rival claim; upon this theory, the King had asserted special authority over widows and orphans, aliens, Jews, lunatics, etc. E. JENKS, *supra* note 12, at 90-91.
60. F. LINCOLN, *supra* note 13, at 10.
61. H.G. RICHARDSON, *supra* note 11, at 1.
62. F. LINCOLN, *supra* note 13, at 10.
63. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 103. Pollock and Maitland believe that the laws of Edward the Confessor are of dubious authority as descriptions of historical fact, perhaps reflecting some unknown 12th-century author's hopeful imagination.

contains a statute that, if not that ancient, adequately describes the Norman period:

> Be it known that all Jews wheresoever they may be in this realm are of right under the tutelage and protection of the King, nor is it lawful for any of them to subject himself to any person of wealth without the King's licence. Jews and all their chattels are the King's property and if anyone withhold their money from them let the King recover it as his own.[64]

As chattels of the King, the Jews retained their own property at his pleasure. In the thirteenth century, Henry de Bracton wrote:

> [a] Jew cannot have anything of his own, because whatever he acquires, he acquires not for himself but for the king, because they do not live for themselves but for others, and so they acquire for others and not for themselves.[65]

They lived where the King permitted, and when they died, their property vested in the King.[66] Because the ecclesiastical courts could proceed only against Christians,[67] the Jews operated free of the Church's usury prohibitions. The civil authorities openly permitted the Jews to lend money at interest and enforced their credit contracts, both for principal and interest.[68] As the Jews prospered the King did too, extracting from them the fruits of their monopoly on usury.[69]

Because it was worthwhile to protect Jewish subjects for their potential money value, successive sovereigns clarified the status of Jews. Charters of Henry I and Henry II[70] granted individual Jews rights to reside in England, to buy and sell goods, and to possess all lands, fiefs, purchases, and pledges com-

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64. F. LINCOLN, *supra* note 13, at 10; 4 S. BARON, *supra* note 3, at 79; 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 468; J.M. RIGG, *supra* note 13, at x. Hovedon, the medieval legal historian, associated the statute with the Justiciar Ranulf de Glanvill. *Id.* at x.

65. 6 H. DE BRACTON, DE LEGIBUS AT CONSUETUDINIBUS ANGLIAE 51 (T. Twiss ed. & trans. 1883).

66. F. LINCOLN, *supra* note 13, at 10-11. Although in theory all property of the deceased Jew reverted to the King, in practice the Crown took only a one-third to one-half share in estate taxes. From Aaron of York, the richest Jew of the time, Henry III exacted anticipatory estate taxes for 19 years before the principal's death. By then, the estate was bankrupt and the heirs destitute. 10 S. BARON, *supra* note 3, at 100-01.

67. H.G. RICHARDSON, *supra* note 11, at 142.

68. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 469 n.1. Only Jews were permitted to "take usury" from a Christian. *See id.* at 473 (Jews had money-lending monopoly). Two contemporary sources, GLANVILL'S TREATISE and the DIALOGUS DE SCACCARIO, describe the penalty exacted from Christians who engaged in "open usury . . . like the Jews": the usurer's chattels were forfeit. TRACTATABUS DE LEGIBUS ET CONSUETUDINIBUS REGNI ANGLIE QUI GLANVILLA VOCATUR (The treatise on the laws and customs of the Realm of England commonly called Glanvill) Book VII, ch. 16, at 89 (G.D.G. Hall ed. & trans. 1965) [hereinafter GLANVILL]; DIALOGUS DE SCACCARIO (The Course of the Exchequer) 100 (C. Johnson trans. 1950). Moreover, if the creditor had executed a mortgage, an instrument that secured the debt by possession of the debtor's land, and later failed to credit the principal of the debt with the income from the land, he violated the condemnation of the Council of Tours. DIALOGUS DE SCACCARIO, *supra*, at 100 n.1. After the creditor's death the debtor might get his land back from the King, but he would then owe the Crown the amount of the principal. In practice, the King forgave part of this amount, presumably reducing it by the sum of the debtor's usurious overpayments. *Id.* at 100.

69. G.M. TREVELYAN, *supra* note 2, at 250-251.

70. These charters are known only by reference in other sources. J. JACOBS, JEWS OF ANGEVIN ENGLAND 137-38 (1893).

ing into their hands.[71] Subject to estate taxes,[72] Jews were permitted to inherit property and loans. Richard I's charter,[73] granted in 1190, confirmed these rights. John affirmed the early charters in 1201, extending their coverage to all Jews and adding the right to hold "mortgages."[74]

Under John's charter, a Jew was free "quietly to sell his gage where it be certain that he has held it for a full year and a day."[75] The charter further clarified that in suits between Jews and Christians, litigation rights were explicit and, in some cases, advantageous to the Jews. The "bare oath" on the Torah of a Jewish defendant sufficed to rebut a charge against him by a Christian plaintiff unaccompanied by witnesses;[76] a Christian defendant similarly situated might be required to "wage his law" with compurgators.[77] A suit against a Jewish defendant was tried by a jury of his "peers."[78] And although a Jewish plaintiff could use a writ to substitute for a required witness, a Christian plaintiff could not.[79] Trials involving Jews and Christians could be held only in the King's courts,[80] while jurisdiction of disputes between Jews remained with the Jewish courts.[81]

But the Jews had fewer rights in themselves and in their possessions than did

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71. 4 S. BARON, *supra* note 3, at 78. The right to possess land was not equal to the right to hold a freehold estate, which would have evoked the full range of feudal obligations between lord and tenant. *See* D. WALKER, *supra* note 17, at 497 (defining freehold). Jews were traditionally excluded from freehold tenure. C. ROTH, HISTORY OF THE JEWS IN ENGLAND 107 (1941); *cf.* H.G. RICHARDSON, *supra* note 11, at 84 (Jews held in fee so rarely that no rule against the practice was needed or established). The request by several Jews to hold land in fee and the actual attempt by one to do so led, in 1271, to a royal mandate denying them the privilege. C. ROTH, *supra*, at 65-66. *See infra* note 161 (discussing mandate of 1271).

72. *See supra* note 66 (describing taxes levied on Jewish estates).

73. For a translation of the charter, see J. JACOBS, *supra* note 70, at 134-37.

74. W. PARKES, THE JEW IN THE MEDIEVAL COMMUNITY 168-70 (1938). The author suggests that the Jews succeeded the monastic houses as moneylenders when the Church declared such activity by Christians to be usurious. *Id.*

75. Carte Libertatum Concessarum et Confirmaturum Jedeis Anglie Anno Regni Regis Johannis Secundo (Charters of Liberties Granted and Confirmed to the Jews of England in the Second Year of the Reign of King John) [A.D. 1201] [hereinafter Charter of King John] para. 7 *printed in* J.M. RIGG, *supra* note 13, at 1-2. The Charter of Richard I had similarly provided: "[T]he aforesaid Jews may sell their pledges without trouble after it is certified that they have held them a year and a day. . . ." J. JACOBS, *supra* note 70, at 136. Compare the time period provided for in *Leviticus* 25:29 (one year must pass before house taken as debt security may be sold).

The rights available to Jews in England contrasted sharply with medieval French tradition. A capitulary of Charlemagne forbade Jews to take the property of the Church or any Christian in pledge for a debt. The penalty was confiscation of the Jew's property and loss of his right hand. Louis the Pious later granted charters to certain Jews permitting free contract rights for sale and exchange of property. S. KATZ, THE JEWS IN THE VISIGOTHIC AND FRANKISH KINGDOMS OF SPAIN AND GAUL 92-93 (1937 & photo. reprint 1970).

76. Charter of King John, *supra* note 75, para. 5. *See also* J.M. RIGG, *supra* note 13, at xii (construing charter).

77. J.M. RIGG, *supra* note 13, at xii. Under the most common 12th-century procedure, the court did not decide facts but allocated the "proof" to one of the parties. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 602-03. The selected party could prove his case by battle, ordeal, or compurgation. *Id.* at 602. In compurgation, the party swore an oath that he was innocent and produced a fixed number of compurgators, or "oath-helpers," who swore that his oath was true. T.F.T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 109 (2d ed. 1936).

78. Charter of King John, *supra* note 75, para. 2. *But see* 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 473 (Jew might have case heard by jury, *half* of whom were Jews).

79. Charter of King John, *supra* note 75, para. 2; J.M. RIGG, *supra* note 13, at xii.

80. Charter of King John, *supra* note 75, para. 8; 1 W. HOLDSWORTH, HISTORY OF ENGLISH LAW 46 (5th ed. 1931).

81. Charter of King John, *supra* note 75, para. 12. In his famous dispute with Henry II, Thomas à

the least vassal to the King. The underlying reality was that the Jews were no more than the embodiment of the King's accounts receivable. Jews were subject to periodic tallage and tithing when the King required them to turn over money that was held, ultimately, on his behalf.[82] The King preserved the Jews and their investments as representing his own financial future.

The royal charters, in effect, permitted the Jews usufruct of money[83] much as their Christian neighbors were permitted use of the land. At the King's pleasure, they could derive a livelihood by lending money at interest. Because Jews could lend money at interest, they were available to finance excursions to continental Europe and on Crusade.[84] In addition to the extraordinary fiscal demands of the Crusades, the nobles still owed knight service. Taxpaying began to replace personal service in the practice of "scutage"—money assessed from landowners in lieu of knight fees.[85] For this too, the Jews' assets were liquid, and available for a fee.

It was convenient to the realm to have a source of credit. It was further convenient that the profits from the loan arrangements, forbidden to Christians, be available to the King via his Jews. And it was to the King's advantage to enforce the contracts of credit made by the Jews.

III. THE JEWISH PRESENCE IN THE DEVELOPING LAW OF COMMERCE

A. IN THE KING'S COURT

The most striking development in English law during the twelfth century was the expansion of the royal courts. Under Henry II, the King's court assumed an increasing share of litigation that previously had been heard only by local courts.[86] This was done through the issuance of royal writs, originally executory commands to the sheriff, but, with time, increasingly representing a formal summons initiating action in the royal courts.[87] Glanvill's treatise, written at the close of the reign of Henry II,[88] is in part a form book of writs instructing the proper method of litigation and procedure. The categories of

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Becket pointed to the Jews' internal juridical independence as an argument for a separate autonomous clergy. 4 S. BARON, *supra* note 3, at 277.

82. 10 S. BARON, *supra* note 3, at 96-99. The Saladin Tithe of 1188, to finance the Third Crusade, demanded that the Jews turn over 60,000 pounds, one-fourth of the value of their entire property in the country. 4 S. BARON, *supra* note 3, at 81.

83. The King forbore from his absolute rights in the Jews' possessions, permitting continued investment to accrue profits for his later use. G.M. TREVELYAN, *supra* note 2, at 251.

84. E. JENKS, *supra* note 12, at 40.

85. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 271-74.

86. R.C. VAN CAENEGEM, ROYAL WRITS IN ENGLAND FROM THE CONQUEST TO GLANVILL 349-51 (1959).

87. *Id.* at 195-97.

88. Glanvill's treatise is believed to have been written between November 29, 1187 and July 6, 1189. GLANVILL, *supra* note 68, at xxx-xxxi. The man whose name the treatise bears, Ranulf Glanvill, was appointed Henry II's chief justiciar in 1180. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 163. After Henry's death in 1189, Glanvill accompanied the new King, Richard I, on Crusade and died in Acre in 1190. *Id.* The authorship of the treatise is unknown but has been attributed to at least three men: Glanvill; Hubert Walter, who became chief justiciar in 1193; and, Geoffrey fitz Peter, the sheriff of Northampton. GLANVILL, *supra* note 68, at xxxi-xxxiii. It is equally likely that the book is the work of an unknown clerk of the King's court. *Id.* at xxxiii.

writs reflect the precise boundaries of the then recognized forms of action.[89]

Among the writs developed during this formative period was the writ of debt.[90] Initially, litigants most commonly used the writ to collect loans of money.[91] Because the Jews were the predominant moneylenders,[92] they would have been the predominant users of the early writ. But the Jews were not merely the unintended beneficiaries of a fortuitous royal innovation. Taken together, the coincident circumstances of the Jews' relation to the King, the then unique form of relief afforded them by their shetars, and certain peculiarities in the wording of the early writs all suggest that the Jews contributed in heretofore unexplained ways to the development of the early writ of debt.

In accord with their traditional practice, when the Jews lent money, they did so under written credit agreements documented in the traditional form of the shetars.[93] Because of his relation to the Jews, the King had manifold interests in enforcing these shetars. And, because "what the Jews held, they held for the King,"[94] what the Jews lost through litigation or to an evasive debtor was lost to the King. Nor were these losses small: the Jews accumulated immense wealth through their moneylending and the King's Exchequer relied heavily on the Jews as an important source of tax revenues.[95] And the King had an even more immediate stake in the revenues from court costs. When the debtor refused to pay, the King enforced the Jewish contracts through his royal court, at a cost of one-tenth to one-sixth of the sum at issue.[96] Yet, despite the royal interest, the questions posed by litigation of the shetar were not questions that English practice was designed to solve.

When a Jew sought to enforce a shetar, he asked alternative forms of relief: payment of the money owed or award of the land and chattels securing the debt.[97] But this request apparently was an aberration from English practice of the early twelfth century.[98] A Jew's request tracked the terms of his unique contract: only a Jewish creditor of a defaulting debtor would be forced to seek either money or security, because only his alien procedure left the debtor in possession of the land pledged to secure the debt.[99]

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89. *See* GLANVILL, *supra* note 68, Book X, ch. 7, at 122 (writ of gage); *id.* Book XII, chs. 3-5, at 150-51 (writs of mort d'ancestor).

90. R.C. VAN CAENEGEM, *supra* note 86, at 254-56.

91. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 207.

92. *See* 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 473 (Jews had monopoly in lending money at interest).

93. *See generally* M.D. DAVIS, *supra* note 42 (reproducing portions of credit agreements between English debtors and Jewish creditors); STARRS & CHARTERS, *supra* note 42 (reproducing Hebrew and Latin portions of credit agreements between English debtors and Jewish creditors).

94. *See supra* text accompanying note 65 (quoting Bracton).

95. *See* H.G. RICHARDSON, *supra* note 11, at 161-75 (discussing heavy taxation of Jews under Kings Henry II, Richard I, and John).

96. *See* 10 S. BARON, *supra* note 3, at 94 (court fee during King John's reign one tenth of debt); R.C. VAN CAENEGAM, *supra* note 86, at 258 (court fees at end of Henry II's reign average one-sixth of debt; during 10th year of John's reign, one-seventh).

97. *See supra* text accompanying notes 36-37 (describing creditor's remedies under shetar).

98. The explicit categorization of actions as real or personal did not arise in English law until Bracton's time. *See* Williams, *The Terms Real and Personal in English Law*, 4 L.Q.R. 394, 398-400 (1888) (Bracton classifies actions; Glanvill does not). *See also* 2 H. DE BRACTON, DE LEGIBUS ET CONSUETUDINIBUS ANGLIAE 290-91 (G.E. Woodbine ed. & S.E. Thorne trans. 1968) (first division of actions).

99. *See* 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 123 (Jewish creditor frequently not in

It appears likely that, at that time, a Christian litigant asked for only a single remedy, either a thing or money. A Christian creditor took and kept possession of the land until the debt was satisfied.[100] In case of default, therefore, his suit would be for money only.[101] If the debtor wrongfully put him out of possession of the land securing the debt, English practice barred the Christian creditor from bringing an assize of novel disseisin to recover the land: the English system relegated him to a suit only for the underlying debt.[102] Conversely, the debtor regained the possessory rights to his property once the underlying debt was satisfied. If the creditor refused to return the security, the debtor's suit would be limited to return of the pledged property.[103] A Jewish creditor was apparently the only person in the realm who would seek execution on a significant personal obligation by either transfer of a thing or payment of a sum.

A Jewish creditor's ability to ask two forms of relief gave him more than the obvious advantage over a Christian creditor. Important procedural privileges inhered in the option of getting real relief for a personal obligation. The conventional litigant, suing on a personal obligation and seeking only money, could not get judgment if the defendant did not appear in court.[104] In contrast, any litigant seeking an award of land would be awarded judgment if the defendant had been absent, without excuse, after three successive summonses.[105] After the defendant's third unexcused absence, the land was "seized into the King's hand" for fifteen days and then adjudged to the plaintiff.[106] Consequently, only a litigant demanding land was assured complete relief regardless of a defendant's attempts to evade the court's power. Other litigants could gain access to defendants' property only through successful attempts to secure defendants' presence through distraint of chattels and lands.[107] This disparate justice dissatisfied Bracton, who proposed that the courts grant relief to claimants of personal obligations who were faced with a defaulting defendant by the distraint and award of the defendant's property.[108] But because this solution

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possession of land securing debt); 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 469 (Jewish credit arrangement novel and alien institution to English because Jewish creditor did not take possession of land securing debt).

100. GLANVILL, *supra* note 68, Book X, ch. 8, at 122-24; 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 120.

101. *See* GLANVILL, *supra* note 68, Book X, ch. 7, at 122 (writ for summoning debtor to redeem gage).

102. *Id.* Book X, ch. 11, at 126; *see* 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 121 ("the creditor is really entitled to . . . the debt, not the land. If he comes into court he must come to ask judgment for that to which he is entitled").

The assize of novel disseisin was a possessory action for land. Through summary process in the King's court, a freeholder recently ousted from land could recover possession by showing prior occupation without the formality of testing legal title. *See* 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 47-52 (describing assize).

103. GLANVILL, *supra* note 68, Book X, ch. 9, 10, at 125 (writ for summoning creditor to restore gage, and different replies of creditor in court).

104. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 594; Williams, *supra* note 98, at 401.

105. GLANVILL, *supra* note 68, Book I, ch. 7, at 5-6; 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 592-93; Williams, *supra* note 98, at 400-01.

106. GLANVILL, *supra* note 68, Book I, ch. 7, at 5-6. This was the procedure under a writ of right for land. *See id.* Book I, ch. 6, at 5 (exemplar of writ initiating action). The procedure for novel disseisin was similar. Williams, *supra* note 98, at 401.

107. Williams, *supra* note 98, at 401.

108. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 594-95.

was not generally adopted until 1832,[109] a Jewish creditor's avenues of enforcement remained unique in medieval England, enabling him to pursue his claim to judgment even though the defendant did not appear to answer the writ.

The Jews asked for a remedy that the English system was unaccustomed to offering. This challenge was met by the King, who himself commanded enforcement of the terms of the shetar. The King first manifested his interest in a command to pay in the form of a writ *praecipe*,[110] which if disregarded, conferred jurisdiction on the King's court.[111] By the shetar's terms, the debtor had the choice of paying the debt or relinquishing the property which secured the obligation. To enforce this choice, the King's command would have had to reflect the divergent remedies: money or property.[112] Eventually, this form of writ *praecipe* evolved into the writ of debt.[113]

The King's intervention on behalf of his Jewish moneylenders may explain and in turn have produced some anomalous terminology in the early development of the writ of debt. The wording of the writ evidences the intrusion of land interests into personal litigation. In the writ, as exemplified in Glanvill, the King ordered the Sheriff to "[o]rder N. to give back justly and without delay to R. a hundred marks which he owes . . . and of which . . . he *deforces him* unjustly."[114] Professor van Caenegem observes that this wording closely

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109. *Id.* at 595.

110. *See* R.C. VAN CAENEGEM, *supra* note 86, at 254 (writ *praecipe* for money originated in Henry I's with commands to Jews' debtors to pay). The writ *praecipe* was a summary order from the King to his sheriff to command someone to do something (here, to pay money owed) prior to judicial determination of the rights of the parties. *Id.* at 234-35. From a purely executive order, the writ developed into a form which initiated judicial process in the King's court. *Id. See generally id.* at 234-35 (discussing development of writs *praecipe*).

Evidence of the issuance of these writs is in the Pipe Roll for the 31st year of the reign of Henry I (1130-31). The Pipe Rolls were the annual balance sheets of the Exchequer, recording the accounts rendered by those responsible for royal revenues, principally the sheriffs. J. JACOBS, *supra* note 70, at 303-04. Because a Jew had to pay the King for the privilege of a writ *praecipe*, a record of the transaction was entered on the Pipe Rolls. Among the entries involving Jews for 1130-31 are the following:

> Rubi Gotsce and other Jews to whom earl Ranulf was indebted, owe 10 Marks of gold for that the king might help them to recover their debts against the earl.
> Abraham and Deuslesalt, Jews, render account of one mark of gold that they might recover their debts against Osbert de Leicester.

Id. at 14-15 (translated from the abbreviated Latin in which the Pipe Rolls were written). Twelfth-century Pipe Rolls also survive for the years 1155 to 1200. *Id.* at 305. Joseph Jacobs has collected and translated many of the entries involving Jews in these Pipe Rolls. *See generally id.* at 44-221 (interspersing select entries from Pipe Rolls from 1155 to 1206).

111. *Id.* at 234.

112. *Cf.* H.G. RICHARDSON, *supra* note 11, at 112-13 (Pipe Rolls indicate most actions in which Jews were plaintiffs were for recovery of money lent or mortgaged land).

113. R.C. VAN CAENEGEM, *supra* note 86, at 254.

114. GLANVILL, *supra* note 68, Book X, ch. 2, at 116-17 (emphasis added). The writ of debt in Glanvill's original Latin read:

> Rex uicecomiti salutem. Precipe N. quod iuste et sine dilatione reddat R. centum marcas quas ei debet ut dicit, et unde queritur quod ipse ei iniuste deforciat. Et nisi fecerit, sumone eum per bonos sumonitores quod sit coram me uel iusticiis meis apud Westmonasterium a clauso Pascha in quindecim dies, ostensurus quare non fecerit. Et habeas ibi summonitores et hoc breue. Teste etc.

Id. This translated in English:

> The king to the sheriff, greeting. Order N. to give back justly and without delay to R. a hundred marks which he owes him, so he says, and of which he complains that he deforces

resembles that of the classic *praecipe* for land.[115] Specifically, the writ of debt adopted the words "unjustly deforces" (*unde . . . ei iniuste deforciat*)[116] from the *praecipe*.[117] To "deforce" is to wrongfully withhold possession of land from one who is lawfully entitled to it.[118] The impropriety of the transplanted terminology, therefore, lies in the sense of the wrong conveyed by the words, "unjustly deforces," which calls for an immediate remedy for an egregious interference with land tenure. But the underlying complaint was default on a debt. Thus the terms of the writ appear to ask for inappropriate relief. Noting the apparent confusion,[119] van Caenegem indicates that Jews were the principal beneficiaries of the early writ.[120]

The "misuse" of the words "unjustly deforces" in the early writs conveys more than just the verbal conservatism of the early common law. Use of the term implies an underlying land obligation securing a certain sum, which strongly suggests the existence of an arrangement like the Jewish shetar. Here, however, the King himself compelled payment in money or in land to be made by the debtor found in breach of a private agreement. The term "deforce," then, communicates the Jew's ability to circumvent the procedural limitations of personal actions.

R.L. Henry has suggested, alternatively, that the writ used "deforce" to connote a breach of the King's peace: as an empty incantation with the single purpose of lending substance to a claim of the King's jurisdiction.[121] The King did not customarily intervene in private disputes.[122] The purported fiction was

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him unjustly. And if he does not do it, summon him by good summoners that he be before me or my justices at Westminster a fortnight after the octave of Easter to show why he has not done it. And have there with you the summoners and this writ. Witness: N. At M.

R.C. VAN CAENEGEM, *supra* note 86, at 437.

115. R.C. VAN CAENEGEM, *supra* note 86, at 254; *see also* 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 173 (writ of debt as given by Glanvill closely similar to writ of right for land known as the *Praecipe in capite*).

116. Approximately: "of which [he] unjustly deforces him." *See supra* note 114 for complete text of writ.

117. R.C. VAN CAENEGEM, *supra* note 86, at 254; 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 204.

118. *See* D. WALKER, *supra* note 17, at 347 (defining deforcement).

119. *See* R.C. VAN CAENEGEM, *supra* note 86, at 254 ("unjustly deforces" was "inappropriate in a personal action for debt, although appropriate enough in a real action for tenure"). Others have also noted the peculiar wording of the writ. *See* R.L. HENRY, CONTRACTS IN THE LOCAL COURTS OF MEDIEVAL ENGLAND 15 (1926) ("[a] person who does not pay his debt may be said to detain something which does not belong to him, but he can hardly be said to 'deforce'"); 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 204-05 (noting peculiarity and explaining it: "The bold crudity of archaic thought equates the repayment of an equivalent sum of money to the restitution of specific land or goods"); A.W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT, THE RISE OF THE ACTION OF ASSUMPSIT 55-56 (1975) (noting peculiarity and concluding: "The use of the word *deforciat* may look slightly curious in a debt writ, but again its use in all probability is not significant").

120. R.C. VAN CAENEGEM, *supra* note 86, at 437.

121. R.L. HENRY, *supra* note 119, at 16. Henry first notes the anomaly posed by the formal declaration in debt litigation in the seignorial courts. There, the plaintiff's claim that the defendant "detains and deforces" the amount of the debt sometimes was supplemented by "against the peace of the lord." *Id.* at 15. Henry theorizes that the local formula mimicked those used in the King's court, because the local lords, like the King, wanted to usurp the traditional jurisdiction of the hundred and county courts. *Id.* at 16.

122. *See* GLANVILL, *supra* note 68, Book X, ch. 8, at 124 ("[i]t is not the custom for the court of the lord king to protect or warrant private agreements of this kind concerning the giving or receiving of things as a gage, or other such agreements, whether made out of court or in courts other than that of the lord king; it follows that, if such agreements are not kept, the court of the lord king will not concern

that withholding payment on a debt breached the King's peace. Henry argues that the formalism was dropped once the action was well-established and the fiction no longer necessary.[123]

But the invocation of the King's peace has another explanation, derived from the unique relationship between the King and his Jews. Because the early actions at debt were principally on behalf of Jews, and because Jews claimed their rights in the King's name, all obligations owed to them were ultimately owed to him.[124] Withholding a debt owed, even indirectly, to the King is a breach of the King's peace that requires no legal fiction. If the price of the writ was paid, the King's courts were ready to stand behind a Jewish creditor's complaint in debt. To enforce the debt was to restore peace to a small part of the realm.

Use of the term "deforce" symbolizes the courts' interference with rights in land. Used to imply "breach of the peace," it invokes the image of the King's wrath. The otherwise puzzling formalism signaled an institutional conflict: in the courts of feudal England, land tenure had been distinct from personal rights in law. Jews were asking the courts to award land—to compel transfer of property to satisfy a personal obligation—before final judgment.[125] Because the King was, in effect, the real party in interest, the interference with land tenure was done with his consent and support. Lacking the King's hand, the action would have been impossible. Only the King's interest in enforcing Jewish creditors' remedies could make possible this invasion of land beyond the limits of relief in personal actions.

The traditional Jewish procedure governing lien-accompanied debt was an innovation in feudal society. The embryonic legal system lacked the terminology to describe a private judicial proceeding for money that jeopardized possession of land. From this came the hybrid use of the term "deforce." "Deforce" disappeared from the King's court shortly after the time of Glanvill,[126] approximately the time when Jewish litigation had been removed to the newly established Exchequer of the Jews.[127] In the seignorial courts, the term fell into disuse by 1291,[128] one year after the expulsion of the Jews from England. Though this may be adventitious, the decline of the phrase and its underlying Royal obligation coincides with the decline of the Jews in England. When the King's Jew was no longer the creditor, default on a debt no longer implicated the interest of the Royal treasury.

B. THE EXCHEQUER OF THE JEWS

At no time during their two-century presence in England were the Jews perceived as more than a necessary evil: a source of capital. The Jews, welcomed

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itself with them, and is therefore not bound to pronounce upon the rights or privileges of the several prior or subsequent creditors").

123. R.L. HENRY, *supra* note 119, at 16.

124. *See supra* text accompanying notes 64-65 (Jews held property ultimately for King).

125. *See* H.G. RICHARDSON, *supra* note 11, at 84-98 (explaining method by which Jews who had been awarded land liquidated their interest in it).

126. 2 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 173.

127. *See infra* notes 129-48 and accompanying text (discussing Exchequer of the Jews).

128. R.L. HENRY, *supra* note 119, at 15.

as moneylenders, were despised as creditors. So long as the King enforced the Jews' debt instruments, the best way to avoid obligation was to attack the Jewish community, destroying people and records. Sporadic incidents culminated in riots against the Jews during the Coronation of Richard I in 1189 and in the Massacre at York in 1190.[129] Beseiged by the mob, hundreds of the York Jews chose death over baptism. The warriors, joining religious hatred to their economic motivation, were quick to destroy the deposits of shetars held within the Jewish community. At York, the riot was instigated by Richard Malebysse, a nobleman deeply indebted to the Jews. After 500 Jews died in the Citadel, Malebysse led the mob to the Cathedral, where they destroyed the debt records, which had been held for safety in the Chapter House. When the smoke cleared, both creditor and debt had been eradicated.[130]

Following his return from the Crusades and release from captivity,[131] Richard I was displeased by the attacks on his Jewish moneylenders. Because duplicates did not exist for many of the documents destroyed, the King was unable to collect debts that would otherwise have escheated to him. He was concerned with preserving a record of debts owed to ensure their payment. By 1200, this concern prompted the establishment of Archae (Registry of Bonds) and of the Exchequer of the Jews.[132]

Archae were established in all towns with sizeable Jewish populations. The registries consisted of Chirograph Chests and four Chirographers—two Christians and two Jews—and their clerks.[133] The Chirograph procedures were strongly reminiscent of traditional Jewish practice.[134] All bonds were to be formalized in the presence of the official witnesses, and immediately duplicated.[135] The original and duplicate were usually written on the same skin and were divided by an irregular cut, producing corresponding tallies.[136] The Archa retained the duplicate, which was called the *pes* or "foot" of the bond, while the creditor retained the original, with the debtor's seal affixed.[137] When the debtor satisfied the debt, the creditor gave the debtor a deed of acquittance.[138] The debtor could then prove satisfaction of the debt only by deliver-

129. J.M. RIGG, *supra* note 13, at xvii-xviii.

130. *Id.*; H. MARGOLIS & G. MARX, A HISTORY OF THE JEWISH PEOPLE 384-88 (1965 reprint). M.D. Davis' collection of shetars includes one recording substantial debts owed by Richard Malebysse. ("out of the great debt which he owes to my master Aaron, and for which I gave him this writing.") In the Hebrew versions of the documents, his name is translated into the Hebrew for "evil beast" (khayah raah), the literal translation of the Norman surname. M.D. DAVIS, *supra* note 42, at 288. This translation was a playful, though prophetic, pun by the creditor. The Hebrew phrase is used in the Book of Genesis by Jacob's sons to describe the animal they falsely claim has devoured their brother Joseph. *Genesis* 37:33. This biblical passage would have been read in synagogues the same week this shetar was written. M.D. DAVIS, *supra* note 42, at 288.

131. The government assessed the Jews 5,000 marks of the 100,000 mark ransom for the release of Richard I. 4 S. BARON, *supra* note 3, at 81-82.

132. J.M. RIGG, *supra* note 13, at xviii-xix; 1 W. HOLDSWORTH, *supra* note 80, at 45-46.

133. J.M. RIGG, *supra* note 13, at xviii-xix. Chirograph, literally "handwriting," was the term used for the written documents.

134. *See supra* notes 34-40 and accompanying text (describing documentary procedure of shetar).

135. J.M. RIGG, *supra* note 13, at xix.

136. *See generally* STARRS AND CHARTERS, *supra* note 42 (photographic plates of bonds, showing irregular cut).

137. J.M. RIGG, *supra* note 13, at xix.

138. *Id.* The acquittance frequently was written on the back of the original bond of debt. 1 STARRS AND CHARTERS, *supra* note 42, at xiv-xv.

ing the acquittance to the Archa, for which he obtained the *pes*, which cancelled the debt.[139] No debt, acquittance, or assignment of debt was valid unless filed in the Chirograph Chest, which could be opened only by order of the Exchequer or in the presence of a majority of the Chirographers.[140]

The King's Exchequer oversaw the King's accounts. A contemporary treatise described its organization and duties: the "Dialogue of the Exchequer."[141] Litigation of Jewish debt instruments comprised a substantial portion of the Exchequer's business, so much so that a separate branch was created to try Jewish causes.[142] Beginning in 1198, "Custodes Judaeorum," or "Wardens of the Jews," were appointed,[143] subordinate to the Exchequer.[144] The Custodes Judaeorum were the first Justices of the Jews. They exercised exclusive jurisdiction over all matters involving Jews and Christians, except those in which the Jew was criminally accused.[145] During the thirteenth century they were charged with enforcing the shetars of the Jews.[146] This special branch of the Exchequer could effectively ascertain the amounts due the King's treasury via the King's Jews.[147]

The Chirograph Chests preserved the bonds of debt and the deeds of acquittance, and the Archae preserved the Chirograph Chests.[148] Many of the pleas brought before the Exchequer of the Jews still survive, and a substantial body of legal paper memorializes the interaction of the thirteenth-century British legal system with the Jewish law of the shetar. Surviving records indicate that the Exchequer of the Jews presided over matters arising from the full range of interactions between Christians and Jews. The primary document offered to prove the transfer of interest in land and the establishment, transfer, or satisfaction of a debt was the shetar.

C. IN THE MATTERS OF COK HAGIN

The records of the Exchequer reveal the tensions between several elements: the King's thinly disguised economic interest, the court's struggle between formalism and alien law, inter-religious suspicions, and everyday venality. Within the pleas of the Exchequer of the Jews, the appearances of one recur-

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139. J.M. RIGG, *supra* note 13, at xix.

140. 1 W. HOLDSWORTH, *supra* note 80, at 45. By 1240, the system had changed: the sealed bond was kept in the Archa, and copies were given to both the creditor and the debtor. 1 STARRS AND CHARTERS, *supra* note 42, at xv.

141. DIALOGUS DE SCACCARIO, *supra* note 68. The unknown author of the 12th century (ca. 1176) "dialogue" describes the exchequer board, a table covered with a checkered cloth, from which the court derived its name. The members of the court sat around an oblong table, ruled off into squares to facilitate a system of accounting (described in detail in the "Dialogus") used to determine debts owed to the King. *Id.* at xxxv-xxxix, 6-7; *see also* 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 191-92 (describing Exchequer as compound institution: judicial tribunal and financial bureau).

142. J.M. RIGG, *supra* note 13, at xx.

143. *Id.* Of the original four "wardens," Simon de Pateshull, Henry de Wichenton, Benedict de Talemunt, and Joseph Aaron, the latter two were Jews. *Id.*

144. 1 W. HOLDSWORTH, *supra* note 80, at 45-46. The Barons of the Exchequer could annul the judgments of the Custodes Judaeorum. *Id.*

145. *See id.* at 46 (cases in which Jews accused of crimes found among Crown Pleas).

146. *See generally* J.M. RIGG, *supra* note 13, at 3-134 (a collection of pleas before the Exchequer of the Jews from 1220 to 1285).

147. *See id.* at xx (King could order scrutiny of Archae to determine financial position of Jews; when done, Archae closed under triple lock and seal and all business suspended).

148. *Id.* at xix.

rent litigant, Cok Hagin,[149] sometime Chief Rabbi,[150] serve as an exemplar of the cultural contact between Jew and Christian. Cok's changing fortunes illustrate not only the limits of the Jews' personal freedom in English society, but also the extensive reliance on Jewish legal practice in the King's court.

Cok's first appearance was in 1272, when the Queen, through her clerk, claimed from him 100 pounds "in ready money." Instead of paying immediately, Cok acknowledged debts to the Crown amounting to 100 pounds, but not in ready money, and asked that the King's Council render judgment. To support the Queen's claim, the Queen's agent appealed to the King's Council, the Queen's Council, and the eyewitnesses to the making of the agreement. Cok agreed to pay the debt in two installments and named four Jews as sureties. If he defaulted, they, equally with him, would be subject to distraint of their lands, debts owing, chattels, and their bodies.[151]

In 1273, Cok appeared with several others to pay a partial sum to delay the tallage assessed in the Easter Term of the first year of Edward I's reign. They asked respite for the greater part owed, and agreed on a penalty that each would owe in default.[152] Later that year, the court noted that the appointed date had passed without payment of tallage or penalty. The penalty was assessed and paid.[153]

One year later, Cok Hagin appeared as co-surety to receive custody of Joce Bundy, a Jew who was charged with lending "money to Christians by blank tallies,"[154]—leaving blank the amount due until after the debtor had signed.[155] Additionally, Bundy was charged with having lived, for some time, in Rayleigh without the King's license. For this offense all Bundy's goods and chattels were forfeit to the Crown. When Bundy failed to appear for his appointed court date, the court found Cok Hagin and his co-surety "in mercy."[156]

In 1275, the King notified his Justices that he had granted all of Cok Hagin's possessions as gifts to his "dearest Consort, Eleanor, Queen of England." She was to receive all of the Jew's debts owing and all his goods and chattels. These were forfeit because Cok Hagin was excommunicate for refusing to submit to trial "according to the Law and Custom of the Jewry."[157] Edward con-

149. "Cok Hagin" is an English corruption of the Hebrew name Yitzhak Hayim. C. ROTH, ESSAYS AND PORTRAITS IN ANGLO-JEWISH HISTORY 24 (1962); C. ROTH, HISTORY OF THE JEWS IN ENGLAND 93-94 (1941).

150. J.M. RIGG, *supra* note 13, at 119 n.1.

151. *Id.* at 67-68. Here, not only the principal, but also his sureties are subject to real actions arising out of a personal obligation.

152. *Id.* at 77.

153. *Id.* at 77.

154. *Id.* at 82.

155. *Id.* at 82 n.1.

156. *Id.* at 82-83. "In mercy" means subject to fine or punishment at the discretion of the court. BLACK'S LAW DICTIONARY 708 (rev. 5th ed. 1979).

157. *Id.* at 87-88. The offense, apparently, is one "against his Law," indicating that the Jew had transgressed against Jewish doctrine rather than against a secular command. *Id.* Other sources report that Cok Hagin was, at the time, on the losing side of a power struggle within the Jewish Community. C. ROTH, ESSAYS AND PORTRAITS IN ANGLO-JEWISH HISTORY, *supra* note 149, at 25.

In their own religious courts, Jews were subject to penalties of excommunication for violation of Jewish law. Religious courts operated independently of the Crown, whose control began only when the defendant was ejected from the protection of his community and formal social position. The excommunicate Jew or the Jew who converted forfeited his goods to the King. *See* J.M. RIGG, *supra* note 13, at 87-88, 96 (excommunicated Jew); *id.* at 99-100 (converted Jew). On leaving his community, a Jew

ditioned this gift to Eleanor upon her making good to the King, before Christmas, "the arrears of the last tallage assessed upon him, the Jew."[158]

By 1282, in the tenth year of Edward's reign, Cok was again doing business.[159] In that term, Cok summoned Roger de Ling to answer for the principal and interest owed on a debt represented by one Chirograph, sworn to be duplicated in the London Chirograph Chest.[160] In the same year, Cok's real estate deals apparently proliferated. In return for a fee interest in a plot of land and a house in London, he exchanged a nine-year term on a farm in Essex in which he had a liveried interest.[161] The farm had been obtained "on account of divers debts" of the former owner, a knight.[162] The prior agreement, transferring the farm, was duly enrolled at the Exchequer. For his new property, Cok Hagin agreed to pay yearly, at Easter, "one gillyflower" to the former tenant and also to render "to the capital lords of the fee the services due and wonted therefor, in discharge of all secular services, customs, and all things exacted and demanded."[163] The two charters, granting respectively the properties to their new owners, contain the warranties, witness attestations, seals, and signatures required by the law of the shetar. The court received these elements as proof of the agreement's validity. The court also recorded that the Queen's attorney was present to give her consent and acknowledgement to Cok Hagin's document.[164]

Cok Hagin's last appearance is as one of a group of the descendants of Master Elias joining together to acknowledge, by their shetar, the acquittance of an ancient debt to their father. As his heir they released the debtor "from the creation to the end of the world." "By spontaneous and unanimous consent," they discharged the debt as fully paid.[165]

The surviving records of the Exchequer of the Jews cover a limited period (1220-1284). Cok Hagin's experience is representative insofar as it illustrates personal and religious disputes, shetars of property transfer, debt registration

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abandoned the role of holding goods for the ultimate use of the King. *See id.* at 61 (goods forfeited by Jew living without King's license, outside Jewish community). The King would have been eager to encourage enforcement of Jewish law, at least to the extent of seizing the goods of those excommunicated.

158. J.M. RIGG, *supra* note 13, at 87.

159. The Queen had encouraged the King to confirm Cok Hagin's election as Chief Rabbi in 1281. *Id.* at 119 n.1. His excommunication apparently had been temporary.

160. *Id.* at 117.

161. *Id.* at 118-20. By a royal edict of 1271, Jews were forbidden to own land. *See* Mandatum Regis Super Terris et Feodis Judaeorum in Anglia. Anno Regni Regis Henrici Quinquagesimo Quinto (Mandate of the King Touching Land and Fees of Jews in England. The Fifty-fifth Year of the Reign of King Henry) [A.D. 1271] *printed in* J.M. RIGG, *supra* note 13, at l-lv (mandate of Henry III prohibiting Jews to have "freehold in manors, lands, tenements, fees, rents or tenures of any kind whatsoever by charter, grant, feoffment, confirmation, or any kind of obligation, or in any other manner," but permitting Jews to dwell in houses in the city). Despite this prohibition, the exchequer record clearly states that Cok Hagin had taken the land "by livery"—i.e., by livery of seisin, a form of land tenure denied the Jews by the preceding edict. Perhaps this was possible through some direct intervention of the Queen or because he held in her name only.

162. J.M. RIGG, *supra* note 13, at 118.

163. *Id.* at 120. It is doubtful that Cok here submitted to knight service, per se, but he likely assumed all taxes (including scutage fees) assessed on the property. *Cf. id.* at xiii (Jew could not swear homage or fealty, which were necessary duties of freeholder in feudal system).

164. J.M. RIGG, *supra* note 13, at 118-20. Cok Hagin was apparently the Queen's chattel. She, not the King, would have power to affirm or deny his actions.

165. *Id.* at 133-34.

and acquittance, and a royal conveyance whereby his goods and, arguably, he himself were granted to the Queen. The Exchequer enforced the law "according to the customs of the Jewry" for nearly a century until the expulsion in 1290. Over time, the alien ways of the Jews had become the subject of everyday litigation in the King's courts.

IV. CONCLUSION: THE EXODUS AND WHAT THE JEWS LEFT BEHIND

Interdicta est iudeis licentia usurandi - Illustration of Jew wearing badge required by 1275 Statute forbidding Jews the practice of usury. (MS British Museum)

Ruling during an era of socio-economic change (1272-1307), Edward was wont to legislate accordingly. And Edward was weary of the Jews.[166] Thus he issued laws forbidding the Jews from holding real property, denying them usurious practice, and ordering them to wear distinctive dress and identifying badges.[167]

Even as he restricted Jewish moneylenders, Edward expanded the universe of non-Jewish moneylending. He had before him a model of secured debt contracts, enforced for centuries by the royal courts for the royal usurers. In the Statute of Merchants of 1285,[168] Edward extended to creditors the forms of registry, remedy, and enforcement that had previously been the substance of the Exchequer of the Jews.[169] Under the Statute, a debtor acknowledged the existence of his debt before the Mayor and one of the recording clerks. The clerks recorded the debt in two rolls, one to remain with the Mayor, one with the clerks. In his own recognizable handwriting, the clerk prepared a debt instrument, to which the debtor affixed his seal and the officials affixed the King's seal. This instrument was given to the creditor, who would present it to the Mayor and the clerks to prove his rights if the debtor defaulted.[170]

More than the enrollment procedures paralleled the structures of the Exchequer of the Jews. The remedies also extended to Christian creditors the relief formerly available only to Jews.[171] No longer was a Christian creditor's

166. *See* T. TOUT, EDWARD THE FIRST 161 (1909) ("Edward disliked the Jews both on religious and economical grounds").

167. *Id.* at 160-62. Edward was following Henry III's precedent, issuing special restrictions for Jews. *See* J.M. RIGG, *supra* note 13 at xlviii-lxi (provisions of Henry III and Edward I). Additionally, Edward's Statutes of Jewry of 1275, *see supra* note 28 (dating statute), denied legal process for the recovery of interest and limited execution on the principal due to one-half of the debtor's land and chattels. J.M. RIGG, *supra*, at xxxviii. English practice no longer required Jewish jurors in cases involving Christians and Jews. Articles Touching the Jewry (undated statute of Edward I, which internal evidence indicates was issued after 1284) *printed in* J.M. RIGG, *supra*, at liv, xli.

168. Statute of Merchants, 1285, 13 Edw., Stat. 3. The Statute of Acton Burnel, 1283, 11 Edw., which was enacted two years before the Statute of Merchants, had been intended to establish a speedy remedy for merchant creditors. Because the sheriffs had failed to apply the statute correctly, the Statute of Merchants of 1285 re-enacted and expanded its provisions. 1 A.W. RENTON, ENCYCLOPAEDIA OF THE LAWS OF ENGLAND 116 (1897).

169. Statute of Merchants, 1285, 13 Edw., Stat. 3.

170. *Id.*

171. *See supra* text accompanying notes 97-109 (comparing remedy available to Jewish creditor under shetar with remedy available to Christian creditor under early common law). In the same year that the Statute of Merchants was enacted, a Christian creditor, for the first time in English law, was

relief before judgment limited by the debtor's absence. If the Christian creditor presented to the Mayor a matured, acknowledged debt instrument corresponding to an enrolled debt, he had established full right to relief.[172] If the debtor did not pay, the creditor eventually obtained access to the debtor's lands,[173] even as the Jews had done for years. And if the creditor were ejected from the debtor's lands, he could bring an assize of novel disseisin to be put back in possession.[174] The Statute of Merchants expressly allowed merchants "damages, and all necessary and reasonable costs in their labors, suits, delays, and expenses,"[175] the same label that disguised otherwise usurious interest in Jewish contracts.[176] Finally, the King assumed the duty of maintaining the Roll of Debts, affixing his seal next to the debtor's and charging one penny for each pound of obligation.[177] The new law expressly excluded Jews.[178]

Five years after the Statute of Merchants, Edward I expelled the Jews from England. Religious hostility was rife. Repeated tallages had depleted the Jews' resources and lessened their value to the King's purse.[179] No longer were the Jews the unique source of credit in England.[180] By the Statute of Merchants, Edward had granted to all non-Jewish creditors the same remedies and procedural rights previously available to Jews. Debts were secured by land, and the security interest survived the death of the creditor and the alienation of the property.

In addition to the property that escheated to the King on their departure,[181] the Jews left behind a law of debtors and creditors developed in the Talmud,

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permitted to elect his remedy. Pollock and Maitland trace the writ of *elegit* (election of remedies) to the adoption by the Second Statutes of Westminster, 1285, 13 Edw., Stat. 1, ch. 18, of the remedy formerly available only to Jewish creditors. 1 F. POLLOCK & F.W. MAITLAND, *supra* note 3, at 475. The election was between a writ of *fieri facias* and transfer of the debtor's property to the creditor. Second Statutes of Westminster, 1285, 13 Edw., Stat. 1, ch. 18.

The Statutes of Westminster introduced another innovation: where before, judgment in debt could be executed only from the debtor's chattels and the fruits of his lands, A.W.B. SIMPSON, *supra* note 119, at 87, now only one half of the debtor's land and his "Oxen and Beasts of the Plough" were immune from execution. Second Statutes of Westminster, 1285, 13 Edw., Stat. 1, ch. 18.

172. Statute of Merchants, 1285, 13 Edw., Stat. 3. *See also* A.W.B. SIMPSON, *supra* note 119, at 127-28 (describing creditor's procedure for relief under Statute of Merchants).

173. *See* Statute of Merchants, 1285, 13 Edw., Stat. 3 (upon creditor's presentation of debt instrument to Mayor, debtor arrested and imprisoned; if he has not paid within three months, he is enabled to sell his lands or chattels to satisfy the debt; if he still has not paid in another three months, a reasonable portion of his lands and chattels are delivered to the creditor to hold as security against ultimate repayment or until the debt is satisfied out of their proceeds). *See also* A.W.B. SIMPSON, *supra* note 119, at 127-28 (same).

174. Statute of Merchants, 1285, 13 Edw., Stat. 3; *cf.* text accompanying note 102 (same remedy had been denied ejected creditor who had held by gage).

175. Statute of Merchants, 1285, 13 Edw., Stat. 3 (translation from 1 STATUTES OF THE REALM, *supra* note 28, at 100 n.4).

176. *See* J.M. RIGG, *supra* note 13, at xxxviii-xxxix (although Statutes of Jewry prohibited their usurious practices, Jewish creditors concealed interest charges as expenses of recovery or penalties for defaults on installments).

177. Statute of Merchants, 1285, 13 Edw., Stat. 3. At fairs, the cost was one and one-half pennies per pound. *Id.*

178. *Id.*

179. *See* 10 S. BARON, *supra* note 3, at 109 (in 1271, the Jews were unable to raise a 6,000 mark tallage imposed for Prince Edward's Crusade).

180. *Id.* at 109-13. As Jewish revenues dropped, Edward borrowed from Italian and Cahorsin merchants. *Id.* at 113.

181. *Id.* at 114. Edward allowed the Jews to take their movable property. T. TOUT, *supra* note 166, at 162.

introduced in the Exchequer, and preserved in the laws of England. Traces of the shetar procedure survived for centuries in English law. A sealed debt continued to be dischargeable only by a deed of release or by cancellation or destruction of the debt instrument.[182] The practice of debt cancellation by requiring return of the *pes* of the chirograph continued from 1194 until its abolition by statute in 1833.[183]

Most important, the encumbrance of real property permitted by the Jewish Law of the shetar had been adopted by English law. Bonds contained the traditional Hebrew formula pledging "all my goods, movable and immovable."[184] Creditors had the statutory right to execute against the debtor's land. No longer were personal obligations and rights in land rigidly separate. Even while Edward was divesting himself of his Jewish moneylenders, he made their legacy permanent. A small but significant principle of Jewish Law, wherein personal debt superseded rights in real property, had become the law of the land.

Judith A. Shapiro

182. A. KIRALFY, THE ENGLISH LEGAL SYSTEM 53 (6th ed. 1978); C.H.S. FIFOOT, HISTORY AND SOURCES OF THE COMMON LAW 231-33 (reprint 1970).

183. F. LINCOLN, *supra* note 13, at 136-38. *See supra* text accompanying notes 137-39 (describing documentary procedure of Archa, under which *pes* was returned to debtor by Archa when debt was paid).

184. J. RABINOWITZ, *supra* note 4, at 254-55. Some bonds further mimicked the shetar, extending the lien to all goods "present and future." *Id.*

CASE COMMENTS

NEPA's Overseas Myopia: Real or Imagined?

Natural Resources Defense Council, Inc. v. Nuclear Regulatory Commission, 647 F.2d 1345 (D.C. Cir. 1981)

In 1969, the United States Congress passed the National Environmental Policy Act (NEPA)[1] to "encourage productive and enjoyable harmony between man and his environment" and to "promote efforts which will prevent or eliminate damage to the environment and biosphere . . . ."[2] To ensure that United States agencies consider the potential environmental impacts of their decisions, NEPA includes a provision that requires agencies to compile an environmental impact statement (EIS) outlining potential environmental effects and possible alternatives to proposed agency actions.[3] In *Natural Resources Defense Council, Inc. v. Nuclear Regulatory Commission*,[4] the United States Court of Appeals for the District of Columbia Circuit addressed the issue of whether the Nuclear Regulatory Commission's decision to permit the exportation of a nuclear reactor to the Philippines required the compiling of an EIS because of the potential environmental effects within that foreign nation.[5] The *NRDC* court held that NEPA's EIS requirement is not applicable to nuclear export licensing decisions.[6] The court's holding is significant because few courts have examined the potentially international scope of NEPA.[7] This comment examines the *NRDC* court's decision and concludes that NEPA, case law, principles of domestic and international law, and foreign policy considerations support a far broader reading of NEPA than the *NRDC* court's narrow interpretation allows.

In 1974 the Philippines government began negotiations with Westinghouse Electric Corporation to acquire a nuclear reactor to be located at Napot Point.[8]

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1. National Environmental Policy Act (NEPA) of 1969, Pub. L. No. 91-190, 83 Stat. 852 (codified as amended at 42 U.S.C. §§ 4321-4347 (1976)).
2. NEPA § 2, 42 U.S.C. § 4321 (1976).
3. NEPA § 102(2)(C), 42 U.S.C. § 4332(2)(C) (1976). Section 102(2)(C) provides:

> To the fullest extent possible . . . all agencies of the Federal Government shall . . . include in every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on (i) the environmental impact of the proposed action, (ii) any adverse environmental effects which cannot be avoided should the proposal be implemented, (iii) alternatives to the proposed action, (iv) the relationship between local and short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and (v) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.

Id.
4. 647 F.2d 1345 (D.C. Cir. 1981).
5. *Id.* at 1366.
6. *Id.*
7. *See infra* notes 57-87 and accompanying text (discussing foreign scope of NEPA).
8. Brief for Petitioners at 6, Natural Resources Defense Council v. Nuclear Regulatory Comm'n, 647 F.2d 1345 (D.C. Cir. 1981) [hereinafter Brief].
The 1974 negotiations were preceded by several agreements that established a framework for the

Upon completion of negotiations in 1976, Westinghouse applied to the Nuclear Regulatory Commission (NRC) for a license to export the nuclear reactor to the Philippines.[9] Early in 1978, the State Department requested that the

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negotiations. In 1968 the Philippines and the United States negotiated an Agreement for Cooperation under which exports of nuclear equipment and materials for research and power applications were held to be subject to the applicable laws, regulations, and licensing requirements of the United States. Brief, *supra* note 8, at 6. In 1971 the Department of State instructed the United States Embassy in Manila to "give all possible encouragement" to the Philippine government to purchase a nuclear power plant from the United States. *Id.* Finally, in March of 1974, the Philippine government requested a preliminary financing commitment from the Export-Import Bank of the United States for the purchase of a nuclear power plant. *Id.*

9. *NRDC*, 647 F.2d at 1351.

Sections 126-129 of the Atomic Energy Act (AEA) set forth the criteria governing nuclear export licensing decisions. AEA §§ 126-129, 42 U.S.C. §§ 2155, 2156, 2157-2158 (Supp. IV 1980) (added by the Nuclear Non-Proliferation Act (NNPA), Pub. L. No. 95-242, §§ 304(a), 305-307, 92 Stat. 120, 131-39 (1978)). Section 304 of the NNPA provides that the NRC shall establish regulations governing the granting, supervision, revocation, or amendment of nuclear export licenses and the level of physical security used to protect facilities and materials. NNPA § 304(b)-(d), 42 U.S.C. §§ 2155a, 2156a (Supp. IV 1980). *See* 10 C.F.R. §§ 110-113 (1982) (NRC regulations governing export licensing decisions).

When a prospective applicant files an application with the NRC for a nuclear export license, the NRC immediately initiates its own licensing review process and forwards the application to the executive branch to trigger a concurrent review. 10 C.F.R. §§ 110.40-.41 (1982). The NRC cannot issue a license unless it has first received, within 60 days of receipt of the application, a recommendation from the executive branch that issuance of the license will "not be inimical to the common defense and security." AEA § 126(a)(1), 42 U.S.C. § 2155(a)(1) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 131-32 (1978)).

If the executive branch does not recommend approval of the license, the NRC may deny or return the application without taking any further action. 10 C.F.R. § 110.44(c) (1982). If the executive branch recommends issuance of the license, the NRC may then grant the license if it believes, based on a "reasonable judgment of the assurances provided and other information available to the Federal Government," that the applicable statutory criteria (set forth in AEA § 127, 42 U.S.C. § 2156 (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 305, 92 Stat. 120, 136 (1978)), are met. AEA § 126(a)(2), 42 U.S.C. § 2155(a)(2) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 131-33 (1978)); 10 C.F.R. § 110.44(a)(1) (1982). Alternatively, if the NRC refuses to issue the license despite executive branch recommendation, because it is unable to make the statutory determinations required by the Atomic Energy Act, the NRC must (1) publish a decision explaining its reasons for denying the license; and (2) forward the application to the executive branch for review by the President. AEA § 126(b)(2), 42 U.S.C. § 2155(b)(2) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 134-35 (1978)); 10 C.F.R. § 110.44(b) (1982).

The President may authorize the issuance of a license the NRC has denied after a determination that "withholding the proposed export would be seriously prejudicial to the achievement of United States non-proliferation objectives, or would otherwise jeopardize the common defense and security." AEA § 126(b)(2), 42 U.S.C. § 2155(b)(2) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 134 (1978)). Prior to the authorization, however, the President must submit an executive order and reasons in support of issuing the license to the Congress. *Id.* The President may also authorize a license if the NRC (1) has failed to act for 120 days following receipt of an executive branch recommendation; and (2) the President finds that "further delay would be excessive." *Id.* This statutory time constraint on the NRC is not applicable, however, if the Commission has commenced procedures for public participation in the licensing review procedures. *Id.*

Section 304(b) of the NNPA provides that the NRC shall promulgate regulations for public participation in nuclear export licensing procedures "when the Commission finds that such participation will be in the public interest and will assist the Commission in making the statutory determinations required [by the Atomic Energy Act]." NNPA § 304(b)(2), 42 U.S.C. § 2155a(a)(2) (Supp. IV 1980). The regulations established pursuant to this mandate constitute the exclusive basis for public hearings on nuclear export license applications. NNPA § 304(c), 42 U.S.C. § 2155a(b) (Supp. IV 1980); 10 C.F.R. § 110.80 (1982).

The regulations established to govern public participation provide that the public may submit written comments to the NRC within 30 days after public notice of receipt of the application. 10 C.F.R. § 110.81 (1982). In addition, a person may request a hearing or petition for leave to intervene in a licensing proceeding. 10 C.F.R. § 110.82(a) (1982). If the request does not establish an interest potentially affected by the license, the NRC may consider whether a hearing would nonetheless be in the public interest or assist the Commission in making its decision. 10 C.F.R. § 110.84(a)(1)-(a)(2) (1982).

NRC defer action on the application because serious questions had been raised concerning the safety of the reactor design, the existence of volcanic and seismic hazards at the site, and the lack of an adequate disposal site for radioactive wastes.[10]

Before the Commission could act on the facility license and on an additional components license application filed after the initial application,[11] the NRC received a petition for leave to intervene and a request for a public hearing on seven issues, including the dangers to the health and safety of both United States citizens residing in the Philippines and Philippine citizens.[12] Prior to the public hearing, the executive branch recommended issuance of the licenses.[13] The facility license recommendation was accompanied by a thirty-seven page "Concise Environmental Review" that discussed site hazards and other health, safety and environmental issues.[14]

In a three-to-two decision, the NRC voted to issue the licenses.[15] The Com-

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If the petition establishes an interest, the NRC must consider the nature of the interest, how the interest relates to the issuance or denial of the license, and the effect of any order denying or granting the license on the interest expressed in the petition. 10 C.F.R. § 110.84(b)(1)-(b)(3) (1982). If the Commission orders a hearing, it must issue a written opinion of its decision upon completion of the hearing. 10 C.F.R. § 110.113(a) (1982). The Commission may base the decision on information outside the hearing and may make its decision prior to the termination of the hearing upon a determination that the public interest requires prompt issuance of the license and that the participant has received a fair opportunity to be heard. 10 C.F.R. § 110.13(b), (d) (1982).

Sections 127 and 128 of the Atomic Energy Act stipulate the licensing criteria that must be satisfied before the NRC can issue a license. AEA §§ 127-128, 42 U.S.C. §§ 2156, 2157 (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, §§ 305-306, 92 Stat. 120, 136-38 (1978)).

10. Brief, *supra* note 8, at 8-17. The site is located on the flank of a mountain within 90 miles of three active volcanoes. *NRDC*, 647 F.2d at 1351; Brief, *supra* note 8, at 10. The site is also located within 50 miles of two United States military installations. *NRDC*, 647 F.2d at 1351. Subic Bay Naval Base is located 12 miles from Napot Point and houses approximately 12,400 United States citizens. Brief, *supra* note 8, at 8. Clark Air Force Base, 42 miles from the site, is a base of approximately 18,000 United States citizens. *Id.*

11. While the NRC was considering the facility license, construction activities had already proceeded at the site using materials not requiring approval by the NRC. Westinghouse Elec. Corp., 11 N.R.C. 631, 633 (1980). Before the Commission had ruled on the facility license, Westinghouse filed a second application seeking authorization to export several components necessary to continue construction. *Id.* Although the executive branch recommended issuance, the NRC deferred action on the components application pending a decision on the facility application. *Id.*

12. *Id.* at 633. The seven issues on which the petitioners requested a hearing included: (1) the nature and magnitude of seismic risks; (2) the adequacy of the reactor's design; (3) the environmental effects of the reactor and disposition of fuel; (4) dangers to the health and safety of Philippine citizens; (5) dangers to the health and safety of United States citizens residing in the Philippines; (6) risks to the operation of United States military installations in the Philippines; and (7) generic safety questions. *Id.* In response to the request for intervention, the NRC ordered public proceedings and solicited views on generic issues relating to the scope of the Commission's jurisdiction to evaluate health, safety, and environmental questions arising from the exportation of nuclear facilities. *Id.* at 634. After determining that it had jurisdiction to decide such issues, the NRC requested new public comments relating to the specific health, safety, and environmental effects the proposed reactor would have upon the global commons and upon the territory of the United States. *Id.* at 634-35. The NRC's request for public comments thus excluded comments relating to potential environmental effects on United States interests in the Philippines and on the citizens of the Philippines.

13. *Id.* at 634.

14. Brief, *supra* note 8, at 19.

15. *Westinghouse*, 11 N.R.C. at 631, 672. The Commission issued two orders. Order CLI-80-14, addressing the merits of the applications, stated that the NRC

> authorizes the issuance of licenses for the export of a nuclear reactor and certain components to . . . the Philippines, determining that the applications meet all the export licensing criteria . . . and that issuance of the licenses would not create unacceptable health, safety, or environmental risks to United States territory or the global commons.

mission first addressed its jurisdiction to act on the applications, holding that (1) the NRC lacks the legal authority to consider health, safety, and environmental effects of an exportation of nuclear facilities upon the citizens of the recipient nation;[16] (2) the Commission has discretion to determine whether to examine health, safety, and environmental effects occurring abroad that could affect United States interests;[17] and (3) the NRC is neither required nor precluded from considering effects on the global commons, provided that the NRC's consideration of such effects does not intrude upon the sovereignty of the recipient nation.[18]

The NRC based its decision to preclude review of impacts occurring within the recipient nation upon the extraterritoriality principle, which limits the application of federal statutes to conduct within, or having an effect within, the territory of the United States unless a contrary intent is clearly indicated in the statute.[19] The Commission argued that its review of statutes governing nuclear exports did not reveal that Congress intended the NRC to take into account health, safety, and environmental effects arising from nuclear exports when they would not have an impact upon United States interests or the global commons.[20] The Commission argued that review of effects upon United States interests is discretionary because the extraterritoriality principle permits the United States to exercise jurisdiction when an action clearly implicates United States interests.[21] Finally, the NRC concluded that it had discretionary jurisdiction to review effects upon the global commons because, by definition, no

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11 N.R.C. at 631. Order CLI-80-15, addressing the jurisdictional issues, stated that the Commission

> decides to adhere to the policy reflected in several earlier export licensing decisions and restricts its consideration of health, safety and environmental effects arising from exports of nuclear reactors to those that could affect the territory of the United States or the global commons.

11 N.R.C. at 672. Commissioners Kennedy and Hendrie wrote the plurality opinion for the NRC, with Commissioner Gilinsky writing a separate opinion concurring in the result. *Id.* at 632, 663. Chairman Ahearne and Commissioner Bradford each wrote separate dissenting opinions. *Id.* at 666.

16. *Id.* at 637.

17. *Id.* at 645.

18. *Id.* at 651.

19. *Id.* at 637. The extraterritoriality principle is a generally accepted rule of domestic United States law. *See* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 38 (1965) (rules of United States statutory law apply only to conduct occurring within, or having effect within, territory of United States, unless contrary clearly indicated by statute) (hereinafter RESTATEMENT). *See also* Foley Bros., Inc. v. Filardo, 336 U.S. 281, 285-88 (1949) (federal statute restricting work hours not applicable to contract between United States and American contractor in Iraq and Iran when language and legislative history revealed no congressional intent to extend coverage beyond borders); *cf.* United States v. Aluminum Co. of Am., 148 F.2d 416, 443-45 (2d Cir. 1945) (Sherman Act applied to actions abroad affecting United States commerce).

The NRC argued that the extraterritoriality principle is closely related to the international law concept of territorial sovereignty. *Westinghouse*, 11 N.R.C. at 637. Under this concept, it is the function of the territorial sovereign to regulate economic and industrial activities occurring within its borders in order to protect persons within the nation. *Id.* at 638. A foreign nation's attempt to regulate such activites is therefore seen as an intrusion into the affairs of the territorial sovereign. *Id.*

20. *Westinghouse*, 11 N.R.C. at 644.

21. *Id.* at 647. The NRC argued that two principles permit limited exceptions to the extraterritoriality principle. *Id.* First, a nation may exercise jurisdiction over the conduct of its nationals, whether the conduct occurs within or outside the nation's territory. RESTATEMENT, *supra* note 19, § 30(1)(a). Second, a nation may determine that it has jurisdiction over an offense, typically criminal, by referring to the national interest injured by the offense. *Westinghouse*, 11 N.R.C. at 647. *See also infra* notes 88-91 and accompanying text (discussing three exceptions to extraterritoriality principle).

single country has jurisdiction over the global commons.[22]

Ruling on the merits, the NRC first held that the applications met the required criteria established under the Atomic Energy Act (AEA).[23] The NRC then determined that issuance of the licenses would not be "inimical to the common defense and security or to the health and safety of the public."[24] The NRC finally reviewed various generic,[25] rather than site-specific, environmental impact statements as required by NEPA and concluded that the potential effects on the global commons and United States territory resulting from the export of the reactor did not require the NRC to deny the licenses.[26] In rejecting the petitioners' claim that NEPA required the agency to assess site-specific effects, the NRC argued that principles of national sovereignty precluded the United States from insisting upon the right to inspect sites located within a foreign nation.[27]

The Natural Resources Defense Council (NRDC)[28] petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the NRC's orders.[29] The NRDC alleged that the NRC violated the Atomic Energy Act by failing to review available and relevant information before determining that the Westinghouse export would not be inimical to public health and safety.[30] The petitioners also claimed that the NRC violated NEPA by failing to prepare a site-specific environmental impact statement considering the potential environmental effects of the reactor in the Philippines, and by

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22. *Westinghouse*, 11 N.R.C. at 651. The NRC contrasted effects occurring within a sovereign nation with those effects occurring in the global commons. *Id.* Because no one nation has sovereignty over areas within the global commons, the NRC argued that an agency may give less weight to sovereignty concerns. *Id.*

23. *Id.* at 653.

24. *Id.* at 656.

25. A generic EIS is one which is prepared without considering the specific site of the project, or any particular problems presented by the specific site.

26. *Westinghouse*, 11 N.R.C. at 659. *See infra* note 175 (discussing generic impact statements relied upon by NRC).

27. *Westinghouse*, 11 N.R.C. at 660. Two Commissioners wrote separate dissents to the plurality's opinion. Although one of the Commissioners agreed with the decision to confine the NRC's jurisdiction to preclude evaluation of environmental effects arising in the recipient nation, he also argued that when a United States interest is involved, the NRC should at least undertake a limited review of existing environmental information. *Id.* at 666 (Ahearne, Comm'r, dissenting).

The other Commissioner argued that the NRC's "legal responsibility to consider the common defense and security, our legal responsibility to consider the health and safety of American populations living overseas, and a policy determination to take some effective responsibility for the safe use of our exports all merge in the direction of a more comprehensive review . . . ." *Id.* at 668 (Bradford, Comm'r, dissenting). He argued that a more extensive review was possible because, in some cases, the agency could attach preconditions to the export and, in most cases, a review could be undertaken on a cooperative basis. *Id.* In addition, the agency could furnish information to the recipient country. *Id.*

28. The NRDC was joined as petitioner by the Philippine Movement for Environmental Protection, the Union of Concerned Scientists, Friends of the Earth, the Sierra Club, and the Center for Development Policy. Brief, *supra* note 8, at 1.

29. *Id.* at 24. The United States courts of appeals have exclusive jurisdiction to review NRC actions. *See* 28 U.S.C. § 2342(4) (Supp. V 1981) (providing courts of appeals with exclusive jurisdiction to determine validity of final orders of Atomic Energy Commission (now NRC); 42 U.S.C. § 2239 (1976) (proceeding for granting or revoking nuclear export license subject to judicial reviw by courts of appeals).

30. Brief, *supra* note 8, at 25. Section 103 of the AEA provides that "no license may be issued . . . if, in the opinion of the Commission the issuance of a license . . . would be inimical to the common defense and security or to the health and safety of the public." AEA, § 103(d), 42 U.S.C. § 2133(d) (1976), *amended by* Act of Aug. 30, 1954, Pub. L. No. 703, 68 Stat. 919, 936.

relying on generic environmental statements with respect to effects on the global commons and on United States territory.[31] In a decision written by Judge Wilkey, the District of Columbia Circuit upheld the NRC's orders.[32]

The District of Columbia Circuit first argued that, in general, requiring the NRC to analyze the foreign effects of a nuclear export license violated the extraterritoriality principle, which prohibits the application of United States laws to foreign nations.[33] Such a requirement also implicates and impairs the ability of the President to conduct United States foreign policy.[34]

The *NRDC* court next examined the statutory mandate of the AEA, as amended by the Nuclear Non-Proliferation Act (NNPA).[35] Section 103 of the Act requires an agency to determine that the proposed export is not inimical to the interests of the United States or the global commons before issuing a nuclear export license.[36] The court concluded that the NRC was neither obligated nor precluded from evaluating the health, safety, and environmental effects occurring within a foreign nation in making the required finding of non-inimicality.[37]

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31. Brief, *supra* note 8, at 72, 78. *See supra* note 3 (text of NEPA § 102(2)(C)).

The two issues addressed by the *NRDC* court clearly involve two different statutory standards. *Compare supra* note 3 (quoting NEPA statutory standard) *with supra* note 30 (quoting AEA statutory standard). The *NRDC* court noted, however, that at least some connection existed between the NNPA and NEPA issues: "[E]ach questions whether there is the duty that an independent agency of the United States explore consequences in which the foreign government is also interested, and, moreover, whether that agency then must be influenced in its own decision-making by the results of the exploration of foreign consequences." 647 F.2d at 1355. Because, however, the resolution of the NEPA issue is not dependent on the resolution of the NNPA issue, the discussion of the NNPA in this comment is limited to those areas in which the NNPA analysis relates to the application of NEPA to foreign projects.

32. *NRDC*, 647 F.2d at 1348. Of the three judges assigned to the case, Judge Wilkey and Judge Robinson filed separate opinions affirming the NRC's decision. Judge Wilkey's opinion is reported first, with Judge Robinson's opinion reported as a concurrence in the judgment. *Id.* at 1345. Judge Ginsberg took no part in the disposition of the case. *Id.* at 1346.

33. *Id.* at 1356. The *NRDC* court noted that although

> this is not a case of the United States imperiously imposing its will on the Philippines . . . [c]onditioning the export license on the health, safety, and environmental standards we think sound for the foreign nation's regulation directs the nation's choices just about as effectively as a law whose explicit purpose is to compel foreign behavior. In short, failure to perceive extraterritorial consequences in [requiring a more complete environmental analysis] would be naive.

Id. The *NRDC* court noted, however, that although the extraterritoriality principle is important, its importance would diminish if the NNPA and NEPA clearly indicated that Congress intended the NRC to consider the environmental effects arising within a foreign nation in its decisionmaking. *Id.* at 1357. The *NRDC* court felt, however, that because the mandate to consider foreign effects under both statutes is vague, a more careful balancing of United States and Philippine concerns was called for. *Id.*

34. *Id.* at 1356. The *NRDC* court concluded that the ultimate responsibility for controlling nuclear proliferation rests in the executive branch and not in the NRC. *Id.* at 1358. The Commission noted that although the NRC's mandate under the NNPA and NEPA necesarily requires the NRC to enter the field of foreign affairs, the NRC's influence over United States nonproliferation policy is complementary to the responsibility of the executive branch. *Id.* at 1358. *See* AEA § 126(b)(2), 42 U.S.C. § 2155(b)(2) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 134-35 (1978)) (President authorized to override NRC denial of nuclear export license in limited situations).

35. 647 F.2d at 1357.

36. *See supra* note 30 (text of AEA § 103).

37. *NRDC*, 647 F.2d at 1359. In reaching this conclusion, the *NRDC* court first analyzed the congressional purpose behind the NNPA, concluding that the NNPA's emphasis on cooperation with foreign nations discourages a regulatory review that is likely to encroach on the sovereignty of a foreign nation. *Id.* at 1359-61. According to the *NRDC* court, the addition of the NNPA to the AEA confirmed Congress' intent that nonproliferation and maintenance of the military balance are to be the

The *NRDC* court concluded its analysis with a brief evaluation of the requirements of NEPA.[38] The court confronted the issue of "whether the federal decision to export a reactor, causing no significant American or global impacts, nevertheless triggers the requirements of a site-specific environmental impact statement, solely because of effects occurring in a foreign jurisdiction."[39] The *NRDC* court invoked the extraterritoriality principle and foreign policy considerations to support its conclusion that NEPA does not require the NRC to consider the foreign effects of a nuclear export licensing decision.[40] The court attempted to support its conclusion with a brief review of the legislative history of the Act, arguing that the legislative history does not serve to illuminate the procedures the NRC is to follow in applying NEPA to a decision concerning a foreign project.[41] In a slightly longer discussion of judical precedent, the *NRDC* court determined that the three cases most relevant to determining the issue involved in the *NRDC* case were both factually distinguishable and inapposite because they presented no foreign policy considerations.[42]

Judge Wilkey attempted to narrow his holding, finding "only that NEPA does not apply to NRC nuclear export licensing decisions—and not necessarily that the EIS requirement is inapplicable to some other major federal action abroad."[43] The opinion, however, represents a dangerous trend toward re-

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indispensable conditions of nuclear export decisions. *Id.* at 1359. *See* NNPA § 3, 22 U.S.C. § 3202 (Supp. V 1981) (providing United States will export nuclear materials, equipment, and technology to nations adhering to nonproliferation policies).

The court next addressed the issue of environmental protection standards, concluding that neither the NNPA nor precedent explicitly require administrative review of environmental effects occurring within a recipient nation. *NRDC*, 647 F.2d at 1361-62. In discussing the NNPA, the *NRDC* court noted that "the provisions of the AEA and NNPA do not stipulate environmental criteria or guidelines." *Id.* at 1361. Rather, the NNPA provides only that the President shall "endeavor to provide . . . for cooperation between the parties in protecting the international environment . . . ." NNPA § 407, 42 U.S.C. § 2153e (Supp. IV 1980). In reviewing precedent, the *NRDC* court noted that the NRC has "consistently declined to number foreign environmental, health or safety impacts among its export licensing requirements." 647 F.2d at 1362 & n.81.

The *NRDC* court concluded its analysis of the AEA by arguing that, as a general rule, the NRC need not look beyond the specific nonproliferation standards of the NNPA when it makes the determination of whether an export will be inimicable to the common defense. *Id.* at 1363. In addition, the *NRDC* court concluded that the NNPA commitment to nuclear reliability indicates that the AEA noninimicality requirement is meant only to obligate the NRC to consider the effects of the export on the American public within the United States. *Id.* at 1364.

38. 647 F.2d at 1366.

39. *Id.*

40. *Id.* According to the *NRDC* court, the language in NEPA itself provides the limitation on NEPA's application to foreign projects. Section 102(2)(F) of NEPA provides that all agencies must "recognize the worldwide and long-range character of environmental problems and, where consistent with the foreign policy of the United States, lend appropriate support to initiatives, resolutions, and programs designed to maximize international cooperation." NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976) (originally enacted as NEPA § 102(2)(E); new subsection (D) added and former subsections (D)-(H) redesignated as (E)-(I) by Act of Aug. 9, 1975, § 102(2)(D), Pub. L. No. 94-83, 89 Stat. 424). For a more detailed discussion of the statutory language in NEPA, *see infra* notes 106-13 and accompanying text.

41. *NRDC*, 647 F.2d at 1366-67. The plurality argued that because Congress can outline national goals only for Americans, NEPA offers a procedural remedy to assist in a solution of American environmental problems. *Id.* Concerning the congressional intent of the NEPA Congress, the *NRDC* court found only that "Congress . . . recognized the merits of cooperation and foreign policy temperance." *Id.* at 1367.

42. *Id.* at 1367-68. *See infra* notes 57-87 and accompanying text (discussing relevant judicial precedent).

43. *NRDC*, 647 F.2d at 1366.

stricting NEPA's applicability to foreign projects. The opinion rests upon a broadly-based application of the extraterritoriality principle and upon broadly phrased foreign policy concerns. Moreover, the *NRDC* court's conclusion that NEPA does not require preparation of an EIS addressing the foreign effects of a nuclear export licensing decision may be equally applicable to other projects with foreign impacts, such as highway construction or pesticide spraying programs.

This comment argues that the *NRDC* court's failure to require the NRC to prepare an EIS evaluating the environmental effects of the proposed export permitted the NRC to violate its duty under NEPA to prepare an EIS "to the fullest extent possible." The comment first reviews judicial interpretations of the Act's EIS mandate in both the domestic and international context, and concludes that courts broadly interpret the scope of the mandate when an agency action may affect either the environment of the United States or a foreign nation. The comment then examines the relationship between NEPA and the extraterritoriality principle, arguing that the *NRDC* court's cursory examination of the extraterritoriality principle failed to consider adequately the three exceptions to the principle, and failed to interpret properly the scope and meaning of the exceptions. The comment further argues that because NEPA dictates only that agencies follow a particular decisionmaking procedure and does not require that agencies reach a particular substantive result, considerations of United States foreign policy and recognition of the sovereignty of foreign nations need not preclude application of the EIS requirement to overseas projects.

The comment proposes that courts reviewing the adequacy of an EIS concerning the environmental effects of a foreign project should require a good faith effort toward compliance. The comment concludes that the *NRDC* court erred by failing to require the NRC to show that it had made a good faith effort to gather as much environmental information about the nuclear reactor project as possible under the circumstances.

I. NEPA AND THE EXTRATERRITORIALITY PRINCIPLE

A. INTERPRETATIONS OF NEPA'S MANDATE

Section 102 of the National Environmental Policy Act provides in part that "to the fullest extent possible . . . all agencies of the Federal Government shall . . . include in every recommendation or report on proposals for . . . major Federal actions significantly affecting the quality of the human environment, a detailed statement on . . . the environmental impact of the proposed action."[44] Relatively few cases have interpreted the section 102 terminology in a foreign context. In order properly to scrutinize the *NRDC* court's abbreviated analysis of NEPA, it is therefore helpful to examine the Act's mandate in both a domestic and an international setting.

Domestic Interpretations. The broad terminology of section 102 provides that NEPA's EIS requirement applies to "all agencies of the Federal

44. NEPA § 102(2)(C), 42 U.S.C. § 4332(2)(C) (1976).

Government."[45] In a domestic setting, courts have interpreted this clause as a congressional mandate that every agency and department consider the environmental impacts of their decisions.[46] This broad application of NEPA to all agencies ensures that every agency will possess the relevant environmental information necessary to make informed decisions on proposed actions.[47]

Although NEPA applies to all agencies, the EIS requirement does not similarly extend to all agency actions. Section 102 limits the need for the preparation of an impact statement to all "major Federal actions significantly affecting the quality of the human environment."[48] The question of whether particular projects meet this criterion is frequently litigated.[49] Courts have recognized, however, that the licensing of a domestic nuclear reactor is a major federal action significantly affecting the environment.[50]

In addition to being limited to major federal actions with significant environmental effects, the NEPA requirement that all agencies consider the environmental impacts of their decisions is also modified by the clause "to the fullest extent possible."[51] The House and Senate conferees who added this language to the Act expressed their intent that agencies should not use the clause as a means to avoid the procedural requirements of section 102.[52] Courts have

45. *Id.*

46. Senator Jackson, the principal sponsor of NEPA, stated that section 102 "directs all agencies to assure consideration of the environmental impact of their actions in decision-making." 115 CONG. REC. 40,416 (1969). *See* Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1112 (D.C. Cir. 1971) (NEPA establishes important procedural provisions designed to ensure that all federal agencies exercise discretion to protect environmental values).

47. Courts have recognized the primacy of the informative function of NEPA. *See, e.g.,* Andrus v. Sierra Club, 442 U.S. 347, 350 (1979) (EIS acts as signal that agency has considered environmental values and consequences during planning stage of action); Kleppe v. Sierra Club, 427 U.S. 390, 409 (1976) (EIS intended to assure consideration by agency of environmental effects of proposed action); Trout Unlimited v. Morton, 509 F.2d 1276, 1282 (9th Cir. 1974) (purpose of EIS to provide decisionmakers with environmental disclosure sufficiently detailed to aid in substantive decision whether to proceed with project); North Slope Borough v. Andrus, 486 F. Supp. 332, 345 (D.D.C. 1980) (EIS designed to ensure that agencies consider environmental consequences of proposed actions); American Timber Co. v. Berglund, 473 F. Supp. 310, 313 (D. Mont. 1979) (purpose of EIS to provide decisionmakers with environmental information to aid in decision whether to proceed with project).

48. NEPA § 102(2)(C), 42 U.S.C. § 4332(2)(C) (1976).

49. *Compare* Natural Resources Defense Council, Inc. v. Nuclear Regulatory Comm'n, 539 F.2d 824, 843-45 (2d Cir. 1976) (NRC grant of interim licensing for commercial processing of reactor fuel major federal action significantly affecting environment requiring EIS) *and* Proetta v. Dent, 484 F.2d 1146, 1149 (2d Cir. 1973) (approval by Economic Development Administration of loan application major federal action significantly affecting environment requiring EIS) *with* American Horse Protection Ass'n v. Frizzell, 403 F. Supp. 1206, 1218 (D. Nev. 1975) (roundup of wild horses would not have significant effect on environment; no EIS required).

50. *See* Public Serv. Co. v. Nuclear Regulatory Comm'n, 582 F.2d 77, 81 (1st Cir. 1978) (licensing of domestic nuclear power reactor major federal action requiring EIS); 10 C.F.R. § 51.5(a)(1) (1981) (issuance of permit to construct nuclear power reactor listed as action requiring EIS).

It is not clear whether the *NRDC* court believed that the issuance of a nuclear reactor export license constitutes a major federal action. The *NRDC* court's only reference to the requirement is contained in the court's attempt to narrow its holding: "I find only that NEPA does not apply to NRC nuclear export licensing decisions—and not necessarily that the EIS requirement is inapplicable to some *other kind of major federal action abroad.*" 647 F.2d at 1366 (emphasis added). The *NRDC* court assumed either that the export decision was not a major federal action, *see id.* at 1385 n.141 (Robinson, J., concurring), or that even if the export decision was a major federal action, competing concerns (such as foreign policy considerations and the extraterritoriality principle) precluded application of NEPA to the action. Judge Robinson argued that there was no need to decide the issue because the precise question of NEPA's international scope was not before the court. *Id.*

51. NEPA § 102, 42 U.S.C. § 4332 (1976).

52. In the conference committee's report on NEPA, the managers on the part of the House stated:

subsequently interpreted this clause as mandating a stringent standard of review in determining whether an agency has complied with the EIS requirement.[53] For example, in *Calvert Cliffs' Coordinating Committee v. Atomic Energy Commission*,[54] the District of Columbia Circuit declared:

> We must state as forcefully as possible that [the "fullest extent possible"] language does not provide an escape hatch for footdragging agencies; it does not make NEPA's procedural requirements somehow discretionary. . . . Indeed, the requirement of environmental consideration "to the fullest extent possible" sets a high standard for the agencies, a standard which must be rigorously enforced by the reviewing courts.[55]

The Supreme Court has also acknowledged this congressional intent, stating that the phrase "to the fullest extent possible" is a "deliberate command" that consideration of environmental factors should "not be shunted aside in the bureaucratic shuffle."[56]

The judicial interpretations of the EIS mandate in a domestic context illustrate the courts' willingness to interpret broadly the scope of section 102. The *NRDC* case, however, arose because of the NRC's failure to prepare a site-specific EIS before making its decision on whether to recommend issuance of a nuclear export license. It is therefore essential to examine the limited judicial precedent interpreting NEPA's procedural requirements in a foreign setting.

Foreign Interpretation. The largest portion of the *NRDC* court's analysis consisted of an examination of judicial rulings on the applicability of NEPA to agency decisions concerning foreign projects. The *NRDC* court concluded that these cases were factually distinguishable and inapposite because they presented no foreign policy considerations. The cases therefore did not compel the production of an EIS to evaluate the foreign effects of a United

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> [I]t is the intent of the conferees that the provision "to the fullest extent possible" shall not be used by any Federal agency as a means of avoiding compliance with the directives set out in section 102. Rather, the language in section 102 is intended to assure that all agencies of the Federal Government shall comply with the directives . . . "to the fullest extent possible" under their statutory authorizations.

CONF. REP. NO. 765, 91st Cong., 1st Sess. 9-10, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2767, 2770.

53. *See, e.g.*, Concerned About Trident v. Rumsfeld, 555 F.2d 817, 823 (D.C. Cir. 1977) (agency compliance with NEPA mandatory absent explicit statutory authorization prohibiting compliance); Port of New York Auth. v. United States, 451 F.2d 783, 789 n.26 (2d Cir. 1971) (quoting legislative history that agency shall not use "to the fullest extent possible" provision to avoid compliance with NEPA); Sierra Club v. Cavanaugh, 447 F. Supp. 427, 431 (D.S.D. 1978) ("to fullest extent possible" language requires that agency decisions be made only after full and good faith consideration of environmental factors); Natural Resources Defense Council, Inc. v. Securities and Exchange Comm'n, 432 F. Supp. 1190, 1198-99 (D.D.C. 1977) ("to fullest extent possible" is deliberate command that duty NEPA imposes on agency to consider environmental factors not be shunted aside), *rev'd on other grounds*, 606 F.2d 1031 (D.C. Cir. 1979); Natural Resources Defense Council, Inc. v. Tennessee Valley Auth., 367 F. Supp. 122, 125 (D. Tenn.) (agency compliance with NEPA mandatory absent explicit statutory authorization prohibiting compliance), *supplemented*, 367 F. Supp. 128 (1973), *aff'd*, 502 F.2d 852 (6th Cir. 1974).

54. 449 F.2d 1109 (D.C. Cir. 1971).

55. *Id.* at 1114.

56. Flint Ridge Dev. Co. v. Scenic Rivers Ass'n, 426 U.S. 776, 787 (1976).

States overseas project.[57] Although the *NRDC* court was admittedly addressing a novel issue, each of the cases the *NRDC* court examined also contained reasoning that supports the application of NEPA's EIS requirement to agency decisions involving foreign projects. Thus, although factual distinctions exist, the reasoning underlying prior opinions may suggest a judicial presumption for the production of an EIS in the *NRDC* situation.

The *NRDC* court first examined *Wilderness Society v. Morton*.[58] In *Wilderness Society*, the District of Columbia Circuit held that a nonresident Canadian citizen and a Canadian environmental group had interests sufficiently antagonistic to the United States plaintiff to justify intervention in an action challenging the adequacy of an EIS prepared for the proposed trans-Alaska pipeline.[59] The *NDRC* court distinguished *Wilderness Society* on three grounds: (1) the *Wilderness Society* case was purely procedural because it dealt exclusively with the permissibility of the Canadian intervention; (2) the *Wilderness Society* court was entirely silent on the issue of whether an EIS must be prepared for a project having an environmental impact solely within a foreign nation; and (3) the United States exercised ongoing control over the pipeline project in *Wilderness Society*.[60]

Although these three grounds support the need for the production of an EIS in *Wilderness Society*, the *NRDC* court placed far too much emphasis on the three grounds in distinguishing *Wilderness Society* from *NRDC*. First, although *Wilderness Society* was a purely procedural inquiry, the Canadian intervenors had to demonstrate that NEPA endowed them with an interest in the litigation before the court could conclude that foreign nationals had a right of intervention.[61] Such a showing of interest is consistent with the view that the scope of application of NEPA does not stop at United States boundaries.[62]

Second, the *NRDC* court's conclusion that *Wilderness Society* did not address the issue of whether an EIS must be prepared for a project having an environmental effect solely within a foreign nation only emphasizes that the *NRDC* court was faced with a novel issue. It is therefore essential to analyze similar cases in order to discover trends in the analysis.

Third, although the *NRDC* court emphasized the United States' "ongoing interest" in the pipeline project, the *Wilderness Society* court did not focus on

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57. *NRDC*, 647 F.2d at 1366. The *NRDC* court did not discuss the role of agencies that comply with NEPA when major federal actions have environmental effects abroad. *See infra* note 151 (discussing government action that has effects abroad).

58. 463 F.2d 1261 (D.C. Cir. 1972) (per curiam).

59. *Id.* at 1261-63. The *Wilderness Society* court concluded that the Canadian and United States interests in the agency's compliance with NEPA differed because either of the possible pipeline locations could potentially result in adverse environmental effects unique to Canada. *Id.* at 1262.

60. 647 F.2d at 1367-68. In his concurring opinion in *Wilderness Society*, Judge Tamm also argued that the issue presented did not involve any separation of powers issues or problems with the interference with the conduct of foreign relations. 463 F.2d at 1263.

61. *See* Enewetak v. Laird, 353 F. Supp. 811, 818 (D. Hawaii 1973) (*Wilderness Society* interpreted as holding NEPA provides foreign nationals with certain rights when their environment is endangered by federal actions). *See also* FED. R. CIV. P. 24(a) (intervention as of right permitted when applicant claims interest in property or transaction which is subject of action and disposition may impair or impede ability to protect interest).

62. Brief, *supra* note 8, at 69.

this interest.[63] In addition, the United States arguably retained an ongoing interest in the Napot Point reactor project that was as strong as the United States' interest in the pipeline: the United States Export-Import Bank had provided financing for the purchase of the nuclear reactor.[64] Moreover, the possible adverse environmental effects from the nuclear reactor in *NRDC* were as significant as the potential environmental effects in *Wilderness Society*.[65] Thus, although the United States could not retain control over the daily operation of the nuclear plant in the Philippines, the United States nevertheless retained an "ongoing interest" in the project based upon the possibility of widespread environmental effects and economic ramifications that would result from trouble with the project. Finally, the *NRDC* court's analysis failed to address the implicit understanding in *Wilderness Society* that NEPA provides foreign citizens with certain rights when their environment is threatened by United States action.[66]

The second case the *NRDC* court discussed was *Enewetak v. Laird*.[67] In *Enewetak* the United States District Court for the District of Hawaii held that the term "nation" as used in NEPA includes the trust territories of the United States,[68] and that the named agencies therefore were required to comply with the provisions of NEPA in initiating and conducting high-explosive tests on a site located in a trust territory.[69] The *Enewetak* court noted that, as in the case of foreign nations, the extraterritoriality principle generally precludes the application of federal legislation to trust territories unless Congress manifests an intent to include the trust territory within the coverage of a given statute.[70] The district court undertook an extensive examination of NEPA's statutory language,[71] its legislative history,[72] and the limited judicial precedent,[73] and concluded that all three supported the conclusion that "the sweep of NEPA is extraordinarily broad, compelling consideration of any and all types of envi-

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63. Rather, the *Wilderness Society* court based its holding on the fact that United States and Canadian interests in the project were different enough to justify intervention. 463 F.2d at 1261-63.

64. Brief, *supra* note 8, at 7.

65. *See supra* note 10 and accompanying text (discussing hazards of Napot Point site).

66. *See supra* notes 61-62 and accompanying text (discussing rights of foreign citizens).

67. 353 F. Supp. 811 (D. Hawaii 1973).

68. *Id.* at 819.

69. *Id.*

70. *Id.* at 815. The extraterritoriality principle is applied to trust territories because, although the United States exercises legislative control over the trust territories, it does not have sovereignty over them. Saipan *ex rel.* Guerrero v. Dep't of Interior, 356 F. Supp. 645, 650 n.10 (D. Hawaii 1973), *aff'd as modified*, 502 F.2d 90 (9th Cir. 1974), *cert. denied*, 420 U.S. 1003 (1975).

71. In its examination of NEPA, the *Enewetak* court argued that the terms of the statute illustrate that Congress did not intend the application of the Act to be limited to the 50 states. 353 F. Supp. at 816. For example, the *Enewetak* court noted that "United States" is not defined in the statute and is only used twice, the word "Nation" is used numerous times, and the statute is phrased in terms of environmental impacts on "man" rather than on "United States citizens." *Id.* at 816-17.

72. The *Enewetak* court looked at the remarks of Senator Jackson, NEPA's principal sponsor, and at the language found in the Conference and House Reports. *Id.* at 817-18. For example, the *Enewetak* court quoted the House report's statement that "implicit in this section is the understanding that the international implications of our current activities will also be considered, inseparable as they are from the purely national consequences of our actions." *Id.* at 817 (quoting H.R. REP. No. 378, 91st Cong., 1st Sess. 386, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2751, 2759). *See infra* notes 114-21 and accompanying text (discussing legislative history).

73. The *Enewetak* court discussed Wilderness Society v. Morton, 463 F.2d 1261 (D.C. Cir. 1972) (per curiam). 353 F. Supp. at 818.

ronmental impact of federal action."[74]

The *NRDC* court argued that because *Enewetak* dealt with the United States Trust Territories, it did not contain the foreign policy considerations present in *NRDC*.[75] This conclusion, however, fails to consider the *Enewetak* court's extensive analysis of NEPA, which led the court to conclude that the Act falls within the congressional intent exception to the extraterritoriality principle. The *NRDC* court totally ignored the *Enewetak* court's analysis of the congressional intent behind NEPA and thus actually reached a conflicting conclusion as to the scope of the international application of the statute.

The final case discussed in the *NRDC* opinion was *Sierra Club v. Adams*.[76] In *Adams*, the United States Court of Appeals for the District of Columbia Circuit held that although the Sierra Club had standing to challenge the adequacy of an EIS prepared to gauge the environmental impacts of proposed highway construction in Panama,[77] the EIS prepared by the government adequately discussed the impacts on the control of aftosa outbreaks, alternatives to the highway, and potential effects of the project on two Panamanian Indian tribes.[78] In concluding that the Sierra Club had standing to challenge the adequacy of the statement's assessment of the environmental effects on the Indians, the *Adams* court explicitly stated that it was only assuming, without deciding, that NEPA is applicable to construction in Panama.[79] The *Adams* court nevertheless allowed the challenge to include coverage in the EIS of the effects on the Indians, arguing that full disclosure, consultation and decisionmaking are at the heart of NEPA.[80]

The *NRDC* Court distinguished *Adams* because the *Adams* court failed to address the question of whether an EIS was even required.[81] The *NRDC* court further argued that in *Adams* the United States retained two-thirds of the ongoing financial responsibility and control over the project, and that the project had possible environmental effects within the United States.[82] These factors allowed the *NRDC* court to conclude that "*Sierra Club* environmental considerations were of a different nature" from those faced by the *NRDC*

74. *Enewetak*, 353 F. Supp. at 817.
75. 647 F.2d at 1368.
76. 578 F.2d 389 (D.C. Cir. 1978).
77. *Id.* at 393.
78. *Id.* Prior to the *Adams* decision, the United States District Court for the District of Columbia had enjoined construction of the highway because the agency had failed to comply with the procedural and substantive requirements of NEPA. Sierra Club v. Coleman, 405 F. Supp. 53, 55-57 (D.D.C. 1975) (hereinafter *Coleman I*). Although the government claimed it had prepared the functional equivalent of an EIS, the *Coleman I* court held that the document prepared was inadequate. *Coleman I*, 405 F. Supp. at 56. The court also found that the government had decided to construct the highway well before preparing the document proffered as the equivalent to an EIS, thus circumventing the congressional intent that agencies prepare an EIS to facilitate environmentally informed decisionmaking. *Id.*
After the government prepared the EIS required by the decision in *Coleman I*, the Sierra Club moved for an extension of the injunction granted in *Coleman I* on the basis that the EIS was still inadequate. Sierra Club v. Coleman, 421 F. Supp. 63, 64-65 (D.D.C. 1976) (hereinafter *Coleman II*). The *Coleman II* court held that the second EIS was deficient because it inadequately dealt with the possibility of aftosa outbreaks and with the potential adverse effects on regional Indian tribes. *Coleman II*, 421 F. Supp. at 65-66.
79. Sierra Club v. Adams, 578 F.2d at 391 n.14.
80. *Id.* at 393.
81. 647 F.2d at 1368.
82. *Id.*

court.[83]

Even assuming that this distinction was valid, the *NRDC* court failed to capture the rationale behind the *Adams* decision. The focus on the well-being of the Panamanian tribes indicates the *Adams* court's realization that an agency cannot prepare a complete EIS, and thus cannot make a fully informed decision, unless it analyzes *all* the environmental effects of a proposed action, including those occuring exclusively within another nation.[84] In addition, the *Adams* court placed great emphasis on the unequivocal congressional mandate that agencies comply with NEPA's procedural requirements "to the fullest extent possible."[85] Thus, the *Adams* court stated, "We emphatically reject the assertion by the Government that something less than a thorough discussion is required because the Indians represent only a small fraction of the Panamanian population, especially since the Government's first environmental impact assessment indicated that the Indians faced possible cultural extinction . . . ."[86] The *Adams* court treated the need to evaluate effects on the tribes as a separate and independent requirement from the need to evaluate effects occurring within the United States.

Although *Wilderness Society*, *Enewetak*, and *Adams* do not hold directly that NEPA's EIS requirement is applicable to projects with environmental effects within a foreign nation, the *NRDC* court nevertheless failed to recognize the fundamental precept underlying these three opinions. All of the cases examined by the *NRDC* court recognized that Congress did not intend to restrict NEPA's EIS mandate to the consideration of purely domestic environmental effects. Courts have interpreted NEPA's mandate in the domestic sphere as a strong and powerful command to agencies to consider the environment in their decisionmaking process.[87] The cases that have interpreted NEPA in a foreign context similarly hold that Congress intended agencies to consider all potential environmental effects which would result from an agency decision to proceed with a project. Although precedent indicates that NEPA may be applicable to decisions concerning foreign projects, the application of NEPA in a foreign context also depends on whether the Act can overcome the presumption against overseas application of United States laws.

B. NEPA AND THE EXTRATERRITORIALITY PRINCIPLE

The extraterritoriality principle provides that "[r]ules of United States statutory law, whether prescribed by federal or state authority, apply only to conduct occurring within, or having effect within, the territory of the United States . . . ."[88] Three exceptions are recognized to this general rule. First, the extraterritoriality principle will not apply when Congress clearly intended the stat-

83. *Id.*

84. Because the Sierra Club had standing to challenge the other issues in dispute, the *Adams* court concluded that to restrict them from challenging additional inadequacies would be "patently inconsistent with the unequivocal legislative intent embodied in NEPA that agencies comply with its requirements 'to the fullest extent possible.'" 578 F.2d at 393.

85. *Id.*

86. *Id.* at 396.

87. *See supra* notes 44-56 and accompanying text (discussing interpetation of NEPA's mandate in domestic setting).

88. RESTATEMENT, *supra* note 19, § 38.

ute to apply outside the boundaries of the United States.[89] Second, the principle is not followed when the nonapplicability of a statute in a foreign setting will result in adverse effects within the United States.[90] Finally, the principle is not applicable when the conduct regulated by the government occurs within the United States.[91] It is essential to determine the interplay between NEPA and the extraterritoriality principle in deciding whether and to what extent NEPA's EIS mandate is applicable to decisions concerning foreign projects.

The NRDC Court's Analysis of the Extraterritoriality Principle. In determining the extraterritorial scope of NEPA, the *NRDC* court focused almost exclusively on the congressional intent exception to the extraterritoriality principle. The *NRDC* court's limited analysis of NEPA's statutory language focused on section 102(2)(F), which requires agencies to "recognize the worldwide and long-range character of environmental problems and, where consistent with the foreign policy of the United States, lend appropriate sup-

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89. *Id.* § 38 reporters' notes 1. *See* Foley Bros., Inc. v. Filardo, 336 U.S. 281, 285 (1949) (statute restricting hours worked not applicable to contract between United States and American contractor in Iraq and Iran when language and legislative history revealed no congressional intent to extend coverage beyond borders). For an example of a statute Congress intended to apply outside the United States, *see* 18 U.S.C. § 953 (1976) (statute regulating private correspondence with foreign governments expressly covers any citizen of United States wherever he may be).

90. Section 18 of the Restatement provides that "[a] state has jurisdiction to prescribe rules of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if . . . the effect within the territory is substantial [and] occurs as a direct and foreseeable result of conduct outside the territory . . . ." RESTATEMENT, *supra* note 19, § 18.

This exception to the extraterritoriality principle may apply even when Congress did not specifically provide that application of the statute was intended to reach conduct outside the boundaries of the United States. RESTATEMENT, *supra* note 19, § 38 reporters' notes 1. For example, the Sherman Antitrust Act has been held to regulate conduct occurring outside the United States when the conduct directly affects the foreign commerce of the United States. In United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945), Judge Learned Hand held that certain commercial agreements made outside the United States nevertheless violated the Sherman Act. 148 F.2d at 444. Judge Hand reasoned that "any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends." *Id.* at 443. *See also* Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 704-05 (1962) (plaintiff's proof of its exclusion from market by subsidiary of foreign government held relevant evidence of Sherman Act violation); *In re* Uranium Antitrust Litig., 617 F.2d 1243, 1254 (7th Cir. 1980) (allegations that 20 domestic and nine foreign corporations conspired to fix price of uranium held within jurisdictional ambit of Sherman Act). *But see* Vanity Fair Mills, Inc. v. T. Eaton Co., 234 F.2d 633, 644 (2d Cir.) (Lanham Act inapplicable to trademark infringement by alien in Canada that had adverse economic effects within United States), *cert. denied*, 352 U.S. 871 (1956).

91. Section 17 of the Restatement provides that "a state has jurisdiction to prescribe rules of law . . . attaching legal consequences to conduct that occurs within its territory, whether or not the significant effect, if any, of the conduct takes place within the territory . . . ." RESTATEMENT, *supra* note 19, § 17.

For example, the Second Circuit, in Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972), held that the United States courts had subject matter jurisdiction over British citizens and corporations that had committed fraudulent acts within the United States in order to cause the American plaintiffs to buy the stock of a British corporation. *Id.* at 1330, 1339. *See also* Arthur Lipper Corp. v. Securities and Exchange Comm'n, 547 F.2d 171, 179 (2d Cir. 1976) (securities laws held applicable to fraud arising out of payments to broker-dealer when fraud perpetrated in United States); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 991 (2d Cir.) (subject matter jurisdiction under securities laws upheld with respect to American residents' losses on stock sale in Canadian corporation effected by distribution of prospectuses from foreign sources), *cert. denied*, 423 U.S. 1018 (1975); United States v. Winter, 509 F.2d 975, 982 (5th Cir. 1975) (jurisdiction upheld over conspiracy designed to have criminal effects in United States).

port to . . . programs designed to maximize international cooperation."[92] The *NRDC* court focused on the latter part of the section, which calls for international cooperation when consistent with foreign policy, and argued that the section evinces congressional concern for cooperative actions.[93]

There are several weaknesses with the *NRDC* analysis. First, the *NRDC* court's argument totally ignores the clause in section 102(2)(F) that calls for agencies to "recognize the worldwide and long-range character" of environmental problems.[94] This phrase demonstrates that Congress intended that agencies look beyond the borders of the United States when evaluating environmental problems.[95] Second, assuming that section 102(2)(F) does indicate congressional concern that agencies act in a manner consistent with United States foreign policy, the *NRDC* opinion implies that section 102(2)(F) is NEPA's sole provision applicable to foreign projects, and that compliance with the requirement of international cooperation is sufficient to relieve the agency from the section 102(2)(C) EIS mandate.[96] This view is inconsistent with the interrelationship of each of the section 102 subsections and the need for compliance with the section 102 mandate as a whole. For example, compliance with section 102(2)(G), which requires agencies to make environmental information available to the states,[97] or compliance with section 102(2)(I), which requires agencies to provide assistance to the Council on Environmental Quality,[98] does not excuse the agency from preparing an EIS.[99] Finally, it is not persuasive to argue that the need for consistency with foreign policy somehow limits an agency's duty to recognize the worldwide character of environmental problems. Congress phrased the section so that "where consistent" modifies the congressional directive to "lend appropriate support to . . . programs designed to maximize international cooperation."[100] The requirement that agencies recognize the worldwide scope of environmental problems is an independent consideration from the requirement to support, when consistent with foreign policy, international cooperation. Similar limiting language is not even found in section 102(2)(C), because the EIS mandate is a procedural re-

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92. NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976).

93. 647 F.2d at 1366.

94. NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976).

95. This language could also be read to include foreign projects that have a domestic impact. The language, however, is not restricted to this interpretation. Rather, the term "worldwide" seems to suggest a concern beyond the United States even if there is no direct domestic environmental effect.

96. 647 F.2d at 1366-67.

97. NEPA § 102(2)(G), 42 U.S.C. § 4332(2)(G) (1976).

98. NEPA § 102(2)(I), 42 U.S.C. § 4332(2)(I) (1976).

99. *See generally* Note, *The Extraterritorial Scope of NEPA's Environmental Impact Statement Requirement*, 74 MICH. L. REV. 349, 361-62 (1975) (hereinafter Note, *Extraterritorial Scope*) (all subsections of section 102(2) interrelated).

100. Section 102(2)(F) requires agencies to "recognize the worldwide and long-range character of environmental problems and, where consistent with . . . foreign policy . . . lend appropriate support to . . . programs designed to maximize international cooperation." NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976). A different conclusion could be reached if Congress had written the statute as follows: "Agencies shall, where consistent with foreign policy, recognize the worldwide character of environmental problems." Had the statute been phrased in this manner, the foreign policy limitation would modify the congressional directive to recognize the worldwide nature of environmental problems.

quirement, not a substantive foreign policy directive.[101] Thus, no foreign policy qualification is necessary.

The *NRDC* court's analysis of NEPA's legislative history is similarly cursory and unsatisfactory. The *NRDC* court concluded that the Act's legislative history "illuminates nothing in regard to extraterritorial application."[102] The court's only basis for this conclusion was the belief that "various pre- and post-enactment hearings" were inconclusive on the issue.[103] The *NRDC* court did not list or analyze any of the applicable legislative history, leaving future courts little or no rationale with which to support the *NRDC* court's narrow reading of NEPA's legislative history.[104] The *NRDC* court's unconvincing examination of statutory language and legislative history does not accurately demonstrate the presence or absence of a congressional intent that NEPA's EIS requirement is to apply to projects that the United States initiates, sponsors, or carries out within a foreign nation.[105] It is therefore necessary to undertake a more complete examination of NEPA in order to determine whether the *NRDC* situation falls within the congressional intent exception to the extraterritoriality principle. Moreover, the court's cursory treatment of the domestic impact and domestic regulated conduct exceptions to the extraterritoriality principle requires an examination of whether the *NRDC* situation falls within either of these two exceptions to the general rule.

Congressional Intent Exception. The language of NEPA, although alone not determinative of congressional intent,[106] demonstrates that Congress was aware of the global nature of environmental issues. Section two of the Act, for example, states in part that the congressional purpose is "[t]o declare a national policy which will encourage productive and enjoyable harmony *between man and his environment*; to promote efforts which will prevent or eliminate damage to the environment and *biosphere* and stimulate the health and welfare of *man* . . . ."[107] The congressional declaration found in Section 101 of NEPA is phrased in similar nongeopolitical language: "The Congress, recognizing the . . . critical importance of restoring and maintaining environmental quality to the *overall welfare and development of man*, declares that it is

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101. *See generally* Note, *Extraterritorial Scope*, *supra* note 99 (section 102(2)(C) procedural safeguard that does not require substantive foreign policy modification).

102. 647 F.2d at 1367.

103. *Id.*

104. For an example of an expansive reading of NEPA's legislative history in a case holding the Act applicable beyond the boundaries of the United States, *see* Enewetak v. Laird, 353 F. Supp. 811 (D. Hawaii 1973). For an example of the District of Columbia Circuit's willingness to interpret broadly the scope of NEPA in a domestic context, *see* Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109 (D.C. Cir. 1971).

105. *Cf.* 647 F.2d at 1385 n.141 (Robinson, J. concurring) (no need to canvas NEPA's extensive legislative history because to decide whether issuance of export license constitutes major federal action would unnecessarily anticipate debate over NEPA's international scope).

106. The determination of whether Congress intended to extend a statute to the regulation of conduct on foreign soil depends partly on an examination of statutory language and legislative history. *See* Watt v. Alaska, 451 U.S. 259, 265 (1981) (courts must examine both language and history to determine legislative intent).

107. NEPA § 2, 42 U.S.C. § 4321 (1976) (emphasis added). Although the remainder of the section deals with domestic goals, the use of national language does not detract from the broad international language of previous clauses. Instead, it merely illustrates Congress' concern with both the domestic and international effects of federal actions.

the continuing policy . . . to create and maintain conditions under which *man and nature* can exist in productive harmony . . . ."[108] The procedural section of NEPA is also phrased in broad language. Section 102(2)(C) requires the preparation of an EIS for major federal actions affecting "the quality of the *human* environment."[109] In addition, section 102(2)(F) specifically requires agencies to "recognize the worldwide and long-range character of environmental problems."[110] Congressional use of such broad language in various parts of the statute is consistent with a broad interpretation of NEPA that requires agencies to evaluate the foreign environmental effects of their actions.[111]

Although the quoted statutory language suggests that Congress was aware that it was not addressing a strictly national problem, NEPA also contains language that has a more national orientation. For example, section two declares that the congressional purpose is to enrich understanding of the ecological resources "important to the nation."[112] Section 101 makes several references to "Americans."[113] The use of language that specifically focuses on the United States, however, does not invalidate the claim that Congress intended NEPA to apply beyond United States boundaries. The existence of both national and nongeopolitical phrases in one piece of legislation demonstrates, at the very least, that Congress had dual concerns. Moreover, the use of some national language demonstrates that Congress knew how to phrase the statute in national terms when it chose to do so. Therefore, the absence of national language in the section 102 EIS mandate supports a broad reading of that part of the statute.

The legislative history of NEPA also illustrates congressional concern for the global environment. Prior to the adoption of the Act Congress published the results of a colloquium convened to examine the establishment of a national environmental policy.[114] The colloquium recommended adoption of a policy that would require "[e]nvironmental quality and productivity [to] be

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108. NEPA § 101(a), 42 U.S.C. § 4331(a) (1976) (emphasis added).

109. NEPA § 102(2)(C), 42 U.S.C. § 4332(2)(C) (1976) (emphasis added).

110. NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976).

111. Although the court in *Enewetak* did not address the identical problem posed in *NRDC*, the *Enewetak* court nevertheless analyzed the scope of NEPA's statutory language. *See supra* notes 67-74 and accompanying text. After quoting various sections of the statute, the *Enewetak* court concluded that NEPA is phrased so expansively that "there appears to have been a conscious effort to avoid the use of restrictive or limiting terminology." 353 F. Supp. at 816.

In Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109 (D.C. Cir. 1971), the United States Court of Appeals for the District of Columbia Circuit broadly interpreted the scope of NEPA in a domestic context, stating, "[t]he sweep of NEPA is extraordinarily broad, compelling consideration of *any and all* types of environmental impact of federal action." *Id.* at 1122 (emphasis added). *See* Note, *Extraterritorial Scope*, *supra* note 99, at 360-65 ("human environment" defined broadly in NEPA to require agencies to prepare EIS for actions with consequences outside the United States).

112. NEPA § 2, 42 U.S.C. § 4321 (1976).

113. For example, section 101(a) declares it to be the policy of the government to "fulfill the social, economic, and other requirements of present and future generations of Americans." NEPA § 101(a), 42 U.S.C. § 4331(a) (1976). Section 101(b) calls for the government to use all practicable means to "assure for all Americans safe, healthful, productive, and esthetically and culturally pleasing surroundings." NEPA § 101(b)(2), 42 U.S.C. § 4331(b)(2) (1976).

114. SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS AND HOUSE COMM. ON SCIENCE AND ASTRONAUTICS, 90TH CONG., 2D SESS., CONGRESSIONAL WHITE PAPER ON A NAT'L POLICY FOR THE ENVIRONMENT [Comm. Print 1968], *reprinted in* 115 CONG. REC. 29078 (1969) [hereinafter WHITE PAPER].

considered in a worldwide context."[115] In addition, events leading to the passage of NEPA illustrate congressional awareness of the international nature of environmental problems. For example, the House subcommittee that held hearings on NEPA[116] heard considerable testimony concerning the need to recognize the international aspects of environmental policy.[117] The Senate bill, as introduced, contained narrowly phrased references to the "[n]ation's ecological systems [and] natural resources."[118] The much less restrictive language eventually adopted as section two of NEPA, however, replaced these phrases.[119] In addition, although the section 102 EIS requirement was not included in the Senate bill as originally introduced, it was later included in the

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115. *Id.*, at 29081-82. The White Paper also stated that "although the influence of the U.S. policy will be limited outside of its own borders, the *global character* of ecological relationships must be the guide for domestic activities. *Ecological considerations should be infused into all international relations.*" *Id.* at 29,082 (emphasis added).

116. The House Subcommittee on Fisheries and Wildlife Conservation of the House Committee on Merchant Marine and Fisheries held the hearings. H.R. REP. NO. 378, 91st Cong., 1st Sess., *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2751, 2752.

117. For example, Margaret Mead argued that "[a]ny discussion has to include the fact that these problems are international . . . . We . . . are setting up in other countries technological problems that are giving them a great deal of trouble." *Environmental Quality: Hearings on H.R. 6750, H.R. 11886, H.R. 11942, H.R. 12077, H.R. 12180, H.R. 12207, H.R. 12209, H.R. 12228, H.R. 12264, and H.R. 12409 Before the Subcomm. on Fisheries and Wildlife Conservation of the House Comm. on Merchant Marine and Fisheries*, 91st Cong., 1st Sess. 26 (1969) (statement of Margaret Mead, Professor of Anthropology); *see also id.* at 108-09 (statement of Dr. S. Dillon Ripley, representing the International Union for Conservation of Nature and Natural Resources) (studies of foreign environment recommended); *id.* at 327 (statement of David M. Gates, Chairman of the Bd. of Advisors to the Ad Hoc Comm. on the Environment) ("we have not yet come to grips with the complexity of the entire ecosystem").

The numerous references to the international aspects of the proposed legislation indicate congressional awareness of the scope of the problem the proposed legislation had to address. A broad interpretation of NEPA recognizes the numerous international references as an important influence on the Congress.

The committee report produced as a result of the hearing, H.R. REP. NO. 378, 91st Cong., 1st Sess., *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2751-67, contains few references to the purpose of the bill, other than an explanation of the congressional purpose behind the establishment of the Council on Environmental Quality. *Id.* at 2751-61. The report nevertheless illustrates the congressional frame of mind at the time NEPA was debated and passed. The report contains numerous references to the international scope of environmental problems. For example, the report quotes testimony from the hearing that "[t]he complexity of the earth's ecosystem and its component parts . . . makes understanding it . . . a massive challenge." *Id.* at 2755 (statement of Dr. David M. Gates, Chairman of the Bd. of Advisors to the Ad Hoc Comm. on the Environment). The report also states that "[t]he testimony at the hearing . . . stressed the importance of the international aspects of the environmental problems." *Id.* at 2757. The report notes that "[t]he international aspects are clearly a major part of the questions which the Council would have to confront . . . ." *Id.* Finally, the report declares that implicit in the section of the legislation requiring the President to report to the Council on the status of the American environmnent "is the understanding that the international implications of our current activities will also be considered, inseparable as they are from the purely national consequences of our actions." *Id.* at 2759. If Congress intended to convey the understanding that both the Council and the President are to consider the international environmental effects arising from United States actions, it is reasonable to infer that Congress also intended that federal agencies operate under a similar implied mandate.

118. S. 1075, 91st Cong., 1st Sess. 1, 115 CONG. REC. 3701, 3701 (1969).

119. The Senate bill as introduced, S. 1075, stated that the purpose of the bill was "to promote and foster means and measures which will prevent or effectively reduce any adverse effects on the quality of the environment in the management and development of the *nation's* natural resources." S. 1075, 91st Cong., 1st Sess. 1, 115 CONG. REC. 3701, 3701 (1969) (emphasis added). As reported out of committee, and eventually adopted, the bill's stated purpose was to "declare a national policy which will encourage productive and enjoyable harmony between *man and his environment*; to promote efforts which will prevent or eliminate damage to the environment and *biosphere*." S. REP. NO. 296, 91st Cong., 1st Sess. 1 (1969); NEPA § 2, 42 U.S.C. § 4321 (1976) (emphasis added). The committee report did not explain the reason for the change, stating only that "[t]he statement of purpose has been revised to reflect amendments adopted by the committee." S. REP. NO. 296, 91st Cong., 1st Sess. 6 (1969).

bill as reported by the Senate committee.[120] The conference committee reported a bill that retained the numerous broadly phrased references to international environmental concerns found in the Senate bill. Senator Jackson, the primary sponsor of NEPA, presented the conference committee's bill to the Senate, stating that NEPA constituted "a congressional declaration that we do not intend, as a government or as a people, to . . . initiate actions which will do irreparable damage to the air, land, and water which support life on earth."[121]

These numerous views indicate the congressional desire to incorporate an international perspective into NEPA. Congress' intent that agencies consider environmental effects beyond the borders of the United States is consistent with the national goals of NEPA. Assuming, however, that the statutory language and legislative history of the Act do not substantiate a claim that Congress intended it to apply overseas, the task of determining whether NEPA falls within one of the exceptions to the extraterritoriality principle is only one-third complete. The *NRDC* court also should have evaluated whether the other exceptions to the extraterritoriality principle apply to extend NEPA's reach to projects with environmental effects occurring within a foreign nation.

Domestic Impact Exception. The *NRDC* court never discussed whether the nuclear export licensing decision fell within the second exception to the extraterritoriality principle, which allows the United States to exercise jurisdiction to regulate conduct outside its borders when that conduct creates an effect within the United States.[122] NEPA contains both substantive goals (found in section 101),[123] and procedural requirements (found in section 102).[124] Even

120. *See* S. REP. NO. 296, 91st Cong., 1st Sess. 6-7 (1969) (statement that new title added and explanation of new sections); *see also infra* note 121 (discussing modifications of section 102(2)(F) terminology).

121. 115 CONG. REC. 40416 (1969) (statement of Sen. Jackson). The conference committee's explanation of the final bill illuminates continuing congressional awareness of the international scope of environmental problems. For example, the conference committee retained the Senate's broad statement of purpose with its references to encouraging harmony between man and his environment and promoting efforts to eliminate damage to the environment. CONF. REP. NO. 765, 91st Cong., 1st Sess. 1, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2767, 2768. The statement of purpose is now section two of the Act. NEPA § 2, 42 U.S.C. § 4321 (1976).

The conference committee's modification of what is now the section 102(2)(F) EIS mandate is particularly interesting. Section 102, as reported by the Senate committee, directed all federal agencies to "[r]ecognize the *worldwide and long-range character of environmental problems* and lend appropriate support to initiatives, resolutions and programs designed to *maximize international cooperation* . . . ." S. REP. NO. 296, 91st Cong., 1st Sess. 2 (1969) (emphasis added). When the bill emerged from the conference committee, it was phrased as it currently appears in the Code, requiring agencies to "recognize the worldwide and long-range character of environmental problems and *where consistent with the foreign policy of the United States*, lend appropriate suport to initiatives . . . designed to maximize international cooperation . . . ." CONF. REP. NO. 765, 91st Cong., 1st Sess. 9, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2767, 2770 (emphasis added); NEPA § 102(2)(F), 42 U.S.C. § 4332(2)(F) (1976) (emphasis added).

122. *See supra* note 90 and accompanying text (discussing domestic impact exception to extraterritoriality principle).

123. *See* NEPA § 101, 42 U.S.C. § 4331 (1976) (congressional declaration of national environmental policy).

124. *See* NEPA § 102, 42 U.S.C. § 4332 (1976) (procedural mandate of NEPA requiring agencies to prepare environmental impact statement and to carry out other duties set forth in section).

In Stryker's Bay Neighborhood Council, Inc. v. Karlan, 444 U.S. 223 (1981) (per curiam), the Supreme Court indicated that NEPA is basically a procedural statute. *Id.* at 224. The Court stated that

assuming the Napot Point reactor would have no substantive environmental effects within the United States, the failure to prepare an adequate EIS nevertheless creates an informational gap which has a procedural effect within the United States.[125] The EIS requirement was designed specifically to provide Congress, government agencies, and the public with the environmental information necessary to make fully informed decisions.[126] Whether a project is undertaken within the United States or in a foreign country with United States support, the failure to prepare an EIS deprives the United States agency responsible for the project of the environmental information it needs to facilitate informed decisionmaking. The failure to prepare an EIS also prevents Congress and the public from effectively overseeing the actions of the agency.[127]

The adverse effects on the decisionmaking process resulting from the failure to prepare an adequate EIS are separate, independent, and fully as significant as the potential environmental effects of the actual construction of the project. As the United States Court of Appeals for the District of Columbia Circuit stated in *Jones v. District of Columbia Redevelopment Land Agency*,[128]

> The harm against which NEPA's impact statement requirement was directed was not solely or even primarily adverse consequences to the environment . . . . Rather NEPA was intended to ensure that decisions about federal actions would be made only after responsible decision-makers had fully adverted to the environmental consequences of the actions . . . . Thus the harm with which courts must be concerned . . . is . . . the failure of decision-makers to take environmen-

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"once an agency has made a decision subject to NEPA's procedural requirements, the only role for a court is to insure that the agency has considered the environmental consequences; it cannot interject itself within the area of discretion of the executive as to the choice of the action to be taken." *Id.* at 227-28.

125. The procedural effects caused by reliance on insufficient information are analogous to the economic impacts discussed in United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945) (Hand, J.). In *Alcoa*, the failure to apply the Sherman Act to regulate conduct occurring overseas would have resulted in economic harm within the United States. *Id.* at 443-44. Similarly, the failure to apply NEPA's EIS mandate to overseas projects results in harm within the United States because the United States government and the public are deprived of the information the EIS is designed to supply.

126. *See supra* note 47 (discussing the primacy of the informational purpose of EIS requirement). The congressional concern evident in section 102(2)(C), that environmental considerations should be integrated "into every process of agency decision-making," NEPA § 102, 42 U.S.C. § 4332(2)(C) (1976), cannot be fulfilled absent the information the EIS is designed to supply.

127. Courts have recognized that one of the major purposes of an EIS is to provide the information necessary for Congress and the public to make an informed review of agency decisions. *See, e.g.*, Izaak Walton League of Am. v. Marsh, 655 F.2d 346, 365 (D.C. Cir. 1981) (one purpose of EIS to ensure that public has opportunity to participate meaningfully in decisionmaking at administrative and legislative levels); County of Suffolk v. Secretary of Interior, 562 F.2d 1368, 1375 (2d Cir. 1977) (EIS enables those who did not participate in compilation to understand and consider factors involved); Minnesota Pub. Interest Research Group v. Butz, 541 F.2d 1292, 1299 (8th Cir. 1976) (EIS provides information to public about environmental costs of project and provides record from which court can determine whether agency considered values NEPA protects); Sierra Club v. Morton, 510 F.2d 813, 820 (5th Cir. 1975) (EIS provides information Congress believed public should have concerning environmental costs of project); Trout Unlimited v. Morton, 509 F.2d 1276, 1282 (9th Cir. 1974) (same); Environmental Defense Fund v. Corps of Eng'rs, 492 F.2d 1123, 1136 (5th Cir. 1974) (EIS should be sufficiently detailed to enable those who did not compile it to understand and consider factors involved); Natural Resources Defense Council, Inc. v. Morton, 458 F.2d 827, 833 (D.C. Cir. 1972) (EIS constitutes environmental source material for Congress, Executive, and public).

128. 499 F.2d 502 (D.C. Cir. 1974).

tal factors into account . . . .[129]

The District of Columbia Circuit also has stated that "most importantly, the [environmental impact] statement makes it possible for 'those removed from the initial process—in other agencies, in Congress, and in the public—to evaluate and balance the factors on their own.'"[130] If Congress and the public are kept aware of agency actions, concern for substantive problems can be expressed through the use of public pressure and legislation.

When a project is located abroad, the need for the agency, Congress, and the public to have the information provided by the EIS is not any less significant than the need for information when a project is located within the United States. In fact, the opposite is arguably true: it is more important for an agency to compile an EIS within the context of a foreign project because of the relative unavailability of information concerning the project other than that provided by the EIS.[131] The collection and provision of information according to NEPA's section 102 mandate provides procedural safeguards within the United States. The *NRDC* court therefore should have considered the second exception to the extraterritoriality principle in light of the potential impact of excusing compliance with the EIS requirement on the domestic decisionmaking process.

Domestic Regulated Conduct Exception. The *NRDC* court did address the third exception to the extraterritoriality principle, which provides the United States with jurisdiction to regulate conduct within its territory whether or not the regulation has foreign repercussions.[132] Although the *NRDC* court acknowledged that NEPA regulates the decisionmaking procedures of United States agencies, the court nevertheless stated that the extraterritoriality principle prevented application of the Act to the NRC decision. Application of the EIS requirement to a foreign project, the court held, would direct a foreign sovereign's actions by conditioning an export license on environmental standards set by the United States.[133]

The *NRDC* court, however, failed to recognize that a foreign nation's actions are not the object being regulated by NEPA. NEPA controls agency

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129. *Id.* at 512.

130. Alaska v. Andrus, 580 F.2d 465, 474 (D.C. Cir.), *vacated in part on other grounds*, 439 U.S. 92 (1978). *Cf.* Atlanta Coalition on the Transp. Crisis, Inc. v. Atlanta Regional Comm'n, 599 F.2d 1333, 1344 n.13 (5th Cir. 1979) (informative purpose of EIS principal motivating factor underlying enactment of NEPA).

131. *See* FISCHER & MERRIL, INTERNATIONAL COMMUNICATION (1970) (discussing difficulties in informational flow between countries); Masmoudi, *The Third World Information Order*, 29 J. COM. 172 (1979) (same).

The NRC should have had no difficulty in compiling an EIS evaluating the project in the *NRDC* case. The government of the Philippines had allowed the NRC to inspect the site and had supplied information relevant to the determinations required to be made by the NRC in a licensing proceeding. Brief, *supra* note 8, at 47. The Philippine government had acknowledged the applicability of the United States licensing criteria and had supplied a report that questioned the safety of the site. *Id.* at 47-48. As the petitioners in the *NRDC* case aptly noted, "the two governments have worked hand-in-glove on the project. For the NRC to refuse, due to sovereignty concerns, to consider information directly or indirectly made available by the Philippine government is manifestly irrational." *Id.* at 48.

132. 647 F.2d at 1355-56. *See supra* note 91 and accompanying text (discussing domestic conduct exception to extraterritoriality principle).

133. *NRDC*, 647 F.2d at 1356.

decisionmaking procedures and provides for adequate congressional and public review of agency decisions.[134] Relying on its statutory authority to determine the factors an agency must consider when exercising its discretionary authority,[135] Congress directed federal agencies to consider the environmental effects their proposed actions might have on the entire biosphere.[136] The Supreme Court has recognized that NEPA's requirements were designed to affect the procedure of United States agency decisionmaking, and do not necessarily mandate any specific outcome.[137] Because NEPA regulates the procedure agencies follow in making decisions, and not the results agencies reach, the application of NEPA to foreign projects would not improperly influence a foreign nation's actions as the *NRDC* court postulated.

The *NRDC* court's cursory examination of the extraterritoriality principle failed to consider adequately the three exceptions to the principle, and failed to interpret properly the scope and meaning of the exceptions. It is possible that one of these exceptions would allow the Act's EIS requirement to be operative. Even if the extraterritoriality principle does not prevent application of the EIS requirement to foreign projects, however, it does not necessarily follow that every foreign project requires a complete domestic-style EIS.

II. BALANCING NEPA AND FOREIGN INTERESTS

The *NRDC* court correctly noted that foreign policy considerations are uniquely involved in the application of NEPA to overseas projects.[138] In addition, a foreign government, although unable to dictate the factors a United States agency should consider in its internal proceedings, possesses shared jurisdiction over the actions of a United States agency when the agency is present within the foreign nation's borders.[139] In compiling an EIS, the potential for the United States to come into conflict with another nation's sovereignty does exist. Rather than abandoning the EIS requirement, however, the *NRDC* court should have recognized that although the requirement that agencies apply NEPA's mandate "to the fullest extent possible"[140] sets a high standard of compliance,[141] the Act's language also provides sufficient flexibility to allow agencies to accommodate considerations of United States foreign policy and

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134. *See supra* notes 47, 127 (discussing informational purpose of NEPA).

135. *See* RESTATEMENT, *supra* note 19, § 17 (state has jurisdiction to prescribe rules of law attaching legal consequences to conduct within territory).

136. Such congressional intent is evident in NEPA's statutory language and in its legislative history. *See supra* notes 106-21 and accompanying text (analyzing language and history of NEPA).

137. *See* Strycker's Bay Neighborhood Council, Inc. v. Karlen, 444 U.S. 223, 224 (1981) (per curiam) (although NEPA establishes significant substantive goals, duties imposed on agencies essentially procedural).

138. 647 F.2d at 1357-58. The Court noted that the NRC's deliberations on the technical aspects of the project would necessarily influence the United States foreign policy program for controlling proliferation of nuclear materials. *Id.* at 1358.

139. Section 17 of the Restatement provides that "a state has jurisdiction to prescribe rules of law . . . attaching legal consequences to conduct that occurs within its territory . . . ." RESTATEMENT, *supra* note 19, § 17.

140. NEPA § 102, 42 U.S.C. § 4332 (1976).

141. *See* Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1114 (D.C. Cir. 1971) ("to fullest extent possible" requirement sets high standard for agency compliance and must be rigorously enforced by courts); *see supra* notes 51-56 and accompanying text (interpretation of "fullest extent possible" requirement).

the sovereignty of other nations.[142]

A. NEPA AND UNITED STATES FOREIGN POLICY

The *NRDC* court expressed two general foreign policy concerns with applying NEPA to foreign projects. First, the *NRDC* court noted that "[i]f the Commission's . . . environmental review of foreign impacts were to impede or challenge the development of foreign nuclear energy programs, it would, in turn, inhibit the conduct of United States foreign relations."[143] The *NRDC* court recognized that the NRC's statutory duty under the Atomic Energy Act to make judgments concerning the non-inimicability of nuclear export applications requires the NRC to enter the field of foreign policy.[144] The *NRDC* court argued, however, that the Commission's influence over foreign policy was intended to be limited.[145] The court supported this conclusion by arguing that the final responsibility for nuclear exports rests in the executive branch; the Commission's task is only complementary.[146] The *NRDC* court thus raised the spectre of agency interference with executive branch foreign policy decisions to support its conclusion that Congress did not intend NEPA to apply to projects with foreign environmental effects occurring within a foreign nation.

The foreign policy argument raised by the *NRDC* court, however, fails on several grounds. First, the President does not necessarily have the final word on all nuclear export decisions. The Nuclear Non-Proliferation Act (NNPA) allows the President to authorize an export by Executive order only when the NRC "is unable to make the statutory determinations" required under the NNPA, provided that Congress does not oppose the President's authorization.[147] In addition, courts have recognized that the requirement of presidential authorization is simply a separate statutory prerequisite for exportation and does not supplant the NEPA requirement.[148] Finally, although the Presi-

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142. Although this comment argues that courts generally require a high standard of compliance with NEPA's procedural mandate, *see supra* notes 53-56 and accompanying text, courts allow for a degree of flexibility in the contents and timing of an EIS. *See, e.g.,* Scientists' Inst. for Pub. Information, Inc. v. Atomic Energy Comm'n, 481 F.2d 1079, 1091-92 (D.C. Cir. 1973) (dictum) (although EIS required to evaluate environmental effects of deployment of breeder reactor, because NEPA covers broad range of activities, the issues, format, length, and detail of EIS must vary); Cady v. Morton, 527 F.2d 786, 796 (9th Cir. 1975) (although certain environmental effects unknown, EIS evaluating effects on water supply of lease of Indian land for strip mining held adequate).

143. 647 F.2d at 1358.

144. *Id.*

145. *Id.*

146. *Id.*

147. Section 126 of the Atomic Energy Act provides:

> If . . . the Commission does not issue the proposed license on a timely basis because it is unable to make the statutory determinations required . . . the Commission shall . . . submit the license application to the President . . . . If . . . the President determines that withholding the proposed export would be seriously prejudicial to the achievement of United States nonproliferation objectives, or would otherwise jeopardize the common defense and security, the proposed export may be authorized by Executive order.

AEA § 126(b)(2), 42 U.S.C. § 2155(b)(2) (Supp. IV 1980) (added by NNPA, Pub. L. No. 95-242, § 304(a), 92 Stat. 120, 134-35 (1978)). Before the President may issue the license, however, he must first submit an explanation of his reasons for issuing the license to Congress, which can adopt a concurrent resolution in opposition to the export. *Id.*

148. *See* Committee for Nuclear Responsibility v. Seaborg, 463 F.2d 788, 791 (D.C. Cir. 1971) (per

dent has power over foreign policy,[149] Congress retains the power to enact legislation to regulate aspects of foreign policy.[150] NEPA's mandate includes the command that "the policies, regulations, and public laws of the United States shall be interpreted in accordance with the policy set forth in [NEPA]."[151] NEPA thus does not interfere with foreign policy, but instead establishes a procedural rule for balancing and guiding conduct.

The second foreign policy argument raised by the *NRDC* court was the concern that "if an EIS requirement attached to nuclear exports, there would be the spectre of litigation over the adequacy of the EIS, with delay the inevitable result."[152] Courts, however, have held that compliance with NEPA is not excused solely because of concern over delay.[153] In addition, courts refuse to

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curiam) (agency not relieved from preparation of EIS solely because President approved of nuclear weapons testing because presidential approval additional statutory requirement).

149. *See* United States v. Curtiss-Wright Export Corp., 299 U.S. 304, 319 (1936) (President is sole organ of federal government in international relations).

150. In Perez v. Brownwell, 356 U.S. 44 (1953), the Supreme Court stated that "[a]lthough there is in the Constitution no specific grant to Congress of power to enact legislation for the effective regulation of foreign affairs, there can be no doubt of the existence of this power in the law-making organ of the Nation." *Id.* at 57. In *Perez*, the Court held that the power of the Congress to regulate foreign relations included the power to deal with the active participation by American citizens in foreign political elections. *Id.* at 59. *See also* MacKenzie v. Hare, 239 U.S. 299, 311-12 (1915) (congressional act providing that American woman takes nationality of husband upon marriage to foreigner upheld).

151. NEPA § 102(1), 42 U.S.C. § 4332(1) (1976). Because Congress expressed the intent that all United States policies and regulations are to be interpreted in accordance with NEPA, the President retains much less power to act contrary to that intent. *See* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 637 (1952) (Jackson, J., concurring) (President's power at lowest ebb when taking measures incompatible with expressed or implied will of Congress).

The *NRDC* court failed to analyze the impact of Executive Order No. 12,114, 44 Fed. Reg. 1957 (1979), on the issue of whether NEPA's EIS requirement is applicable to projects with foreign effects. The order, although based on authority independent of NEPA, also claims to "further the purposes of NEPA . . . consistent with foreign policy and national security policy of the United States." 44 Fed. Reg. 1957 (1979). The order also purports to represent the "exclusive and complete determination of the procedures and other actions to be taken by Federal agencies to further the purposes of the National Environmental Policy Act, with respect to the environment outside the United States." *Id.*

The executive order establishes a three-tier system for the assessment of environmental effects occurring outside of the United States. If the agency determines that an action will significantly affect the environment of the global commons, the agency is required to prepare an environmental impact statement similar to a domestic EIS. *Id.* at 1957-58. If the action will affect the environment of a foreign nation that (1) is not involved in the project, or (2) the United States is providing with listed products or projects, the agency may prepare either a bilateral or multilateral environmental study, or a concise review of the environmental issues. *Id.* The order allows an agency to modify these documents when necessary to enable the agency to act promptly or to avoid adverse impacts on foreign relations. *Id.* at 1959.

For example, the regulations governing the National Aeronautics and Space Administration require the agency to determine initially whether an action involves potential environmental effects on the global commons and on foreign nations not participating in the project. 14 C.F.R. § 1216.321(a)(1), (2) (1982). If the action will have effects in one of these categories, the agency is required to determine whether the action may have a significant environmental effect abroad. *Id.* § 1216.321(b). If the agency determines that the action may have a significant effect abroad, the agency is required to prepare an EIS detailing effects on the global commons. *Id.* § 1216.321(d)(1). The agency has discretion, however, to decide whether an EIS is necessary to evaluate other effects abroad. *Id.* § 1216.321(d)(1).

The relationship between the executive order and NEPA is not clear. Although the order purports to be the exclusive determination of the procedures to be taken by federal agencies when a project has environmental effects arising outside of the territory of the United States, courts have not addressed the constitutional issue of whether the executive order and the agency regulations promulgated pursuant to the order subsume NEPA. *See* Note, *The Extraterritorial Application of NEPA Under Executive Order 12,114*, 13 VAND. J. TRANSNAT'L L. 173 (1980).

152. 647 F.2d at 1366.

153. *See, e.g.,* Natural Resources Defense Council, Inc. v. Nuclear Regulatory Comm'n, 539 F.2d

excuse agencies from compliance with the Act even in the presence of major policy concerns other than environmental protection. Thus, in *Concerned About Trident v. Rumsfeld*,[154] the District of Columbia Circuit refused to imply a national defense exception from NEPA for the decision on where to base the Trident nuclear submarine program, even though the project had "serious national security implications."[155] Similarly, in *Greene County Planning Board v. Federal Power Commission*,[156] the Second Circuit required the preparation of an EIS for a "vitally needed" power facility, stating that "the spectre of a power crisis 'must not be used to create a blackout of environmental consideration in the agency review process.'"[157] Courts have clearly indicated that NEPA's mandate exists side-by-side with non-environmental policy considerations as important as the national defense and energy policy.[158]

824, 843 (2d Cir. 1976) (interim criteria established pending development of final regulations governing licensing procedures for mixed oxide fuel activities rejected when interim criteria considered delay, because delay not justification for noncompliance with procedural mandate of NEPA); Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1127-28 (D.C. Cir. 1971) (AEC's argument that considerations of delay precluded action on environmental issues raised during pre-operating, post-construction stage of nuclear facility rejected); Mobil Oil Corp. v. Federal Trade Comm'n, 430 F. Supp. 855, 872-73 (S.D.N.Y. 1977) (FTC required to prepare EIS when requested divestiture of pipelines and refinery capacity would effect environment despite need for prompt action in antitrust prosecutions). *But see* Conservation Soc'y of S. Vermont, Inc. v. Secretary of Transp., 508 F.2d 927, 933 (2d Cir. 1974) (refusal to issue injunction to halt highway construction when equities, including urgency attending completion of project, favored defendants, although delay alone does not justify noncompliance with NEPA).

154. 555 F.2d 817 (D.C. Cir. 1977).

155. *Id.* at 823.

156. 455 F.2d 412 (2d Cir.), *cert. denied*, 409 U.S. 849 (1972).

157. *Id.* at 422-23 (quoting Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1122 (D.C. Cir. 1971)). *See* Rhode Island Comm. on Energy v. General Services Admin., 397 F. Supp. 41, 58 (D.R.I. 1975) (spectre of energy crisis cannot excuse preparation of EIS where GSA considering transfer of government land to electric utility for use as nuclear plant site).

158. Thus, the concern over nuclear proliferation is no more important than environmental concerns and projects that involve a nonproliferation issue cannot be exempted from NEPA's requirements solely on that basis. Exemption from legislation by implication is not generally favored. Courts instead require either an affirmative showing of an intention to exempt, or the presence of an irreconcilable conflict between an earlier and a later statute. *See* Tennessee Valley Auth. v. Hill, 437 U.S. 153, 189-93 (1978) (continuing appropriations for Tellico Dam did not constitute repeal of Endangered Species Act when no irreconcilable conflict existed between statutes); Morton v. Mancari, 417 U.S. 535, 550 (1974) (rule prohibiting employment discrimination on basis of race did not repeal provision aimed at furthering Indian self-government when no irreconcilable conflict present). Similarly, courts have held that repeal of NEPA by implication is disfavored. *See* Realty Income Trust v. Eckerd, 564 F.2d 447, 458 n.38 (D.C. Cir. 1977) (congressional approval of appropriations not conclusive determination of sufficiency of EIS); Committee for Nuclear Responsibility v. Seaborg, 463 F.2d 783, 785 (D.C. Cir. 1971) (per curiam) (passage of authorization and appropriations for testing of nuclear warhead did not represent determination of sufficiency of EIS). Even when substantive legislation is involved, inapplicability of NEPA is generally found only in the face of strong legislative intent to exempt from NEPA, *see* Texas Comm. on Natural Resources v. Bergland, 573 F.2d 201, 209-10 (5th Cir. 1978) (congressional decision to permit clearcutting in national forests not subject to indirect review through process of requiring EIS), or a clear statutory conflict, *see* Atlanta Gas Light Co. v. Federal Power Comm'n, 476 F.2d 142, 150 (5th Cir. 1973) (NEPA did not curtail FPC's statutory duty to take effective interim curtailment actions in exigencies presented by gas shortage).

It is clear that in enacting the NNPA, Congress did not intend for nuclear exports to be approved at the expense of the environment. First, the enactment of the NNPA was not intended to prejudice the debate on the application of NEPA to nuclear exports. 124 CONG. REC. 1449-50 (remarks of Senator McClure). Second, the NNPA provides that the NRC may not issue a nuclear export license if the issuance "would be inimical . . . to the health and safety of the public." NNPA § 103, 42 U.S.C. § 2133(d) (1976). Thus, the NNPA neither presents sufficient evidence of congressional intent to repeal NEPA, nor represents a clear statutory conflict with its goals. The policies of both statutes present separate, but necesary, statutory requirements the NRC must fulfill before approving an application for

There are instances in an international setting, however, when it may be impossible to comply fully with NEPA. It would not be feasible, for example, to require the preparation of an EIS before conducting military actions overseas. NEPA, however, does not require such a result. Although section 102 applies to all federal actions significantly affecting the human environment, courts have also recognized that NEPA's requirements may be superseded when they clearly conflict with other statutory requirements.[159] Thus, although NEPA exists side-by-side with other, non-environmental policy considerations, it should not be applied in the face of a clear delegation of overriding authority to carry out a competing policy. Similarly, if the President acts by means of constitutionally delegated powers which, contrary to the power exercised over nuclear exports, supersede, rather than supplement, the agency's authority to act,[160] courts should not require the agency's actions to comply fully with NEPA.

B. NEPA AND FOREIGN SOVEREIGNTY

In addition to United States foreign policy considerations, the overseas application of NEPA also raises concern over the recognition of the independence of a foreign sovereign.[161] The *NRDC* court claimed that application of the Act's EIS requirement would displace the foreign nation's own environmental standards, and thereby violate the country's own sovereignty.[162] The *NRDC* court, however, failed to recognize that the EIS mandate is procedural, and substantively flexible, allowing an agency to defer to the differing environmental standards that a foreign nation may hold.[163] For example, the House

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a nuclear export license. *See generally* Note, *The Environmental Impact Statement Requirement in Agency Enforcement Adjudication*, 91 HARV. L. REV. 815, 827-28 (1978) (exemptions from section 102(2)(C) because of statutory conflict have resulted only when preparation of EIS prevented agency from developing own policy).

159. *See* Flint Ridge Dev. Co. v. Scenic Rivers Ass'n, 426 U.S. 776, 791 (1976) (NEPA's impact statement inapplicable when compliance conflicted with statutory time constraints established under Disclosure Act); *cf.* Pacific Legal Found. v. Andrews, 657 F.2d 829, 835-37 (6th Cir. 1981) (NEPA inapplicable when compliance did not serve purposes of either Endangered Species Act or NEPA and actions taken under ESA already fulfilled NEPA's purposes). Courts, however, will hold that NEPA's EIS requirement is mandatory when compliance with NEPA is not irreconcilable with another statutory goal. *See, e.g.,* Texas Comm. on Natural Resources v. Bergland, 573 F.2d 201, 208 (5th Cir. 1978) (no irreconcilable conflict existed between imposition of land management guidelines and NEPA compliance); Concerned About Trident v. Rumsfeld, 555 F.2d 817, 823 (D.C. Cir. 1977) (per curiam) (Navy required to prepare EIS evaluating effects of Trident program despite potential national security implications); Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1125 (D.C. Cir. 1971) (obedience to water quality certifications not mutually exclusive of NEPA procedures). The legislative history applicable to the EIS requirement states that the language "to the fullest extent possible" was added to the statute to clarify that an agency is to comply with NEPA's EIS mandate "unless the existing law applicable to such agency's operations expressly prohibits or makes full compliance with one of the directives impossible." CONF. REP. NO. 765, 91st Cong., 1st Sess. 9, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2767, 2770.

160. For example, the President could probably halt the export of nuclear materials during a time of war pursuant to his constitutionally delegated power to act as Commander in Chief. U.S. CONST. art. II, § 2. The fact that a case touches on foreign affairs, however, does not necessarily place it beyond legislative control. *See supra* note 150 (discussing power of Congress to regulate foreign affairs).

161. *See* RESTATEMENT, *supra* note 19, § 17 comment b (when United States regulates conduct within borders that has extraterritorial effects, foreign nation may also have jurisdiction).

162. 647 F.2d at 1356.

163. Section 101 sets forth the substantive policies of NEPA. NEPA § 101, 42 U.S.C. § 4331 (1976). The section provides that it is the affirmative duty of all federal agencies "to use all practicable means,

Committee on Merchant Marine and Fisheries oversight hearings on NEPA addressed a State Department claim that the application of NEPA to foreign projects would impose United States environmental standards on foreign nations, stating:

> [The State Department is] incorrect in its assumption that the preparation of 102 statements would in any way impose American environmental values upon foreign countries . . . . [T]he requirement of 102 impact statements operates primarily to inform both the aid grantor and the aid recipient of just what environmental consequences may properly be expected as a result of the program, and what alternatives may be available to minimize the adverse affects.[164]

In preparing and considering an EIS, the agency should take into account the standards of the foreign sovereign. In his dissent to the NRC's decision in *NRDC*, Commissioner Bradford of the NRC argued that an environmental impact statement should not be the basis of a denial of an export license in any but the most extraordinary case.[165] Implicit in Commissioner Bradford's conclusion is the belief that an EIS should be prepared even in a foreign context because its procedural nature ensures that information will be gathered by the agency, and yet does not dictate that the agency reach a particular substantive result, based solely on United States environmental standards.

Thus the *NRDC* court's concern that the application of NEPA to an overseas project would displace a foreign sovereign's environmental standards is misplaced. Recognition of the procedural nature of NEPA guards against such a result by giving agencies the freedom to defer to a foreign nation's own environmental standards. If, however, an agency feels compelled to preclude United States participation in a foreign project based upon the potential environmental consequences of the action, the ultimate standard for the denial should be based upon a determination that it is in the best interests of the United States not to participate. In the *NRDC* case, for example, possible United States interests that could provide a legitimate basis for the denial of the reactor export license may include the possible effect of an ecological disaster on relationships between the United States and other foreign countries, or

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consistent with other essential considerations of national policy" to protect and achieve the environmental values listed in the statute. NEPA § 101(b), 42 U.S.C. § 4331(b) (1976). The District of Columbia Circuit has interpreted this language as establishing a flexible policy that does not require the agency to reach a particular substantive result. *See* Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109, 1112 (D.C. Cir. 1971) (substantive policy of NEPA is flexible and may not require particular substantive results).

In contrast to the language found in the substantive provisions of NEPA, the procedural provisions establish a strict standard of compliance. For example, section 102 requires agencies to comply with NEPA's procedural mandate "to the fullest extent possible," NEPA § 102, 42 U.S.C. § 4332 (1976), in comparison to the substantive mandate to use "all practicable means and measures," NEPA § 101, 42 U.S.C. § 4331 (1976). *See* Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d at 1112 (NEPA's procedural provisions establish strict standard of compliance); *see also supra* notes 51-56 and accompanying text (discussing high standard of compliance required for fulfillment of NEPA's procedural mandate).

164. COMMITTEE ON MERCHANT MARINE AND FISHERIES, ADMIN. OF THE NAT'L ENVTL. POLICY ACT, H.R. REP. NO. 316, 92d Cong., 1st Sess. 33 (1971). The committee report noted that the United States is free to impose conditions upon the grant of unilateral aid, including consideration of the environmental implications of the action. *Id.*

165. 647 F.2d at 1354.

the belief that the export will not advance the concerns set forth in other statutes.[166] By denying a foreign project the right to proceed based upon United States interests, the NRC would not be determining what constitutes an acceptable environmental hazard for the Philippines. Rather, the agency would be measuring the effects within or related to the United States.

Assuming that the procedural nature of NEPA allows the preparation of an EIS without dictating the substantive result, the preparation of an EIS evaluating the foreign environmental effects of a United States project nevertheless raises a second sovereignty concern. A foreign government is free to prevent a United States agency from collecting the data necessary to prepare an environmental impact statement from within its territory.[167] The foreign government may choose to cooperate with an agency by granting access to the site of the project and supplying information concerning internal affairs to the agency.[168] If, however, a foreign government refuses to cooperate, it may be difficult or impossible for an agency to prepare an EIS containing the full details that an EIS prepared to evaluate a domestic project would contain. The agency would have to decide whether to withhold approval of a particular project altogether, or to prepare a more limited EIS that incorporates the information the foreign nation does choose to make available.[169]

CONCLUSION

When an agency decides to approve a project after considering an EIS, interested parties may decide to challenge the sufficiency of the EIS. Reviewing courts that have addressed challenges to the adequacy of an EIS evaluating the environmental impacts of a domestic project generally have held that the test of compliance with the procedural provisions of section 102 of NEPA is an objective standard of good faith.[170] Courts utilize a rule of reason, recognizing

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166. The *NRDC* court failed to analyze whether the presence of approximately 32,000 American servicemen on military bases near the proposed reactor site warranted the preparation of an EIS. Their presence may have been sufficient to require denial of the export license if an evaluation of environmental effects of the export indicated the servicemen would be in danger. In his concurrence to the *NRDC* opinion, Judge Robinson noted that the NRC's decision to make only a minimum evaluation of the potential environmental effects on American interests abroad "is hardly the most commendable outcome one can envision." 647 F.2d at 1380 (Robinson, J., concurring). Judge Robinson later argued, however, that because he perceived no "compelling indication" that the NRC's reading of its required duties under NEPA was incorrect, the *NRDC* court must defer to the agency's judgment. *Id.* at 1382. Judge Robinson further qualified his support of the *NRDC* opinion by arguing that he was unable to understand how the NRC could fail to include American bases as part of the United States' common defense and American servicemen as part of the American public. *Id.*

167. *See supra* note 161 (jurisdiction of a foreign nation to restrict United States involvement in its affairs).

168. *See supra* note 131 (Philippine cooperation in supplying reactor site information).

169. This comment argues that the agency must prepare an EIS to evaluate the environmental effects in a foreign nation of licensing a nuclear reactor because it is a major federal action significantly affecting the environment. This discussion therefore does not analyze the standard of compliance and burden of proof issues that arise when an agency is challenged because of its threshold determination not to prepare an EIS. For such a discussion, *see generally* Note, *Threshold Determinations Under Section 102(2)(C) of NEPA: The Case for "Reasonableness" as a Standard for Judicial Review*, 16 WM. & MARY L. REV. 107 (1974) (standards for judicial review of negative threshold determinations).

170. For example, the District of Columbia Circuit, in Calvert Cliffs' Coordinating Comm., Inc. v. Atomic Energy Comm'n, 449 F.2d 1109 (D.C. Cir. 1971), stated that it is the reviewing court's responsibility to reverse an agency decision if the decision "was reached procedurally without individualized consideration and balancing of environmental factors—conducted fully and in good faith." *Id.* at 1115.

that the EIS requirement does not mandate perfection or intend for the agency to document every potential consequence of a decision to proceed with a project.[171] Rather, the EIS need contain only sufficient information to provide decisionmakers with the facts necessary to make informed decisions and to provide Congress, the public, and the courts with sufficient information to be able to meaningfully review the decision.[172]

Courts reviewing the adequacy of an EIS prepared to evaluate the environmental effects of a foreign project should similarly utilize a good faith standard of compliance.[173] The informational purpose of the EIS, whether it is prepared for a domestic or a foreign project, remains the same. A good faith standard requires the agency to make a bona fide effort to gather the information necessary to make an informed decision from all available sources, including the foreign nation. However, in determining what effort constitutes good faith compliance in a foreign setting, courts should take into consideration the foreign policy and sovereignty concerns unique to the foreign setting. If the agency requests information and the foreign nation refuses to cooperate, the agency's preparation of an EIS with the remaining available information should be sufficient to demonstrate the agency's good faith compliance, to the fullest extent possible, with NEPA's EIS mandate.[174]

For cases holding that the test of compliance with the procedural provisions of section 102(2) is a standard of good faith objectivity, rather than subjective impartiality, *see* Isle of Hope Historical Ass'n v. Army Corps of Eng'rs, 646 F.2d 215, 220 (5th Cir. 1981) (per curiam) (good faith compliance standard is objective); County of Suffolk v. Secretary of Interior, 562 F.2d 1368, 1375 (2d Cir. 1977) (same); Minnesota Pub. Interest Research Group v. Butz, 541 F.2d 1292, 1300 (8th Cir. 1976) (same); Sierra Club v. Morton, 510 F.2d 813, 819 (5th Cir. 1975) (same); Iowa Citizens for Environmental Quality v. Volpe, 487 F.2d 849, 852 (8th Cir. 1973) (same); Environmental Defense Fund, Inc. v. Corps of Eng'rs, 470 F.2d 289, 296 (8th Cir. 1972) (same). *See also infra* note 172 (cases finding good faith compliance).

171. *See* Minnesota Pub. Interest Research Group v. Butz, 541 F.2d 1292, 1300 (8th Cir. 1976) (preparation of objection-free document not purpose of EIS).

172. *See id.* at 1300 (purpose of EIS to give Congress, agencies, and public useful decisionmaking tool); Iowa Citizens for Environmental Quality v. Volpe, 487 F.2d 849, 851 (8th Cir. 1973) (EIS serves as basis for consideration of environmental factors by agency and for critical evaluation by those not associated with its preparation).

Courts have found good faith reliance in a broad variety of contexts. *See, e.g.,* Minnesota Pub. Interest Research Group v. Butz, 541 F.2d 1292, 1300-06 (8th Cir. 1976) (objective good faith compliance found despite defendant's contentions that analysis in EIS merely catalogued unexplained conclusions and that EIS failed adequately to discuss effects associated with lost timber and alternative actions); Sierra Club v. Morton, 510 F.2d 813, 818-19, 821 (5th Cir. 1975) (objective good faith compliance found despite allegations of inadequate or nonexistent pre-EIS research when agency recognized and presented significant effects in final statement); Environmental Defense Fund, Inc. v. Corps of Eng'rs, 470 F.2d 289, 295-96 (8th Cir. 1972) (objective good faith compliance found despite allegations agency official biased toward completion of flood control project because test of compliance is not subjective impartiality); Ventling v. Bergland, 479 F. Supp. 174, 179-80 (D.S.D. 1979) (objective good faith compliance found despite allegation that site-specific EIS is necessary when programmatic EIS included comprehensive analysis of effects of timber management).

173. In Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978), the Supreme Court held that courts cannot require agencies to employ procedures beyond those required in the Administrative Procedure Act. *Id.* at 538-40. The establishment of a good faith standard of compliance is not, however, an attempt to establish the procedures an agency is to employ. Rather, it is solely a requirement that an agency making decisions concerning overseas projects follows at least the minimum statutory criteria, set forth in NEPA, that all agencies shall comply with the Act's mandate "to the fullest extent possible." The *Vermont Yankee* Court upheld the courts' ability to ensure that agencies follow at least the minimum criteria established in a statute. *Id.* at 548.

174. Assuming a good faith standard of compliance, it is also necessary to determine which party should bear the burden of showing that the standard has or has not been met. In a domestic context, when an agency determines that an EIS is *not required* because a project lacks significant environmen-

Under an approach that requires a standard of good faith compliance, the goal of any agency examining a foreign project remains the preparation of a complete EIS, similar in detail to an EIS prepared for a domestic project. When preparation of such an EIS is impossible, however, courts should not automatically excuse an agency from compliance with NEPA's mandate. Rather, an agency should be excused from compliance only to the extent it can demonstrate a good faith effort to create as complete an EIS as is possible under the circumstances. The degree of compliance that will demonstrate good faith depends upon the facts of each case, and may range from an EIS that only eliminates discussion of possible alternatives to the proposed foreign project to an EIS that is phrased in broad, general terms and deals exclusively with the environmental effects of a project on the global commons. The ultimate error made by the *NRDC* court was its failure to require the NRC to show that it had made a good faith effort to gather and compile as much environmental information as possible.[175] By failing to require a good faith showing, the *NRDC* court allowed "the duty NEPA imposes upon agencies to consider environmental factors [to] be shunted aside in the bureaucratic shuffle."[176] In contrast, requiring an agency to prepare in good faith an EIS in a

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tal effects, courts generally have placed the burden of proving compliance with NEPA on the government, after a threshold showing of significant effects is made by the plaintiff. *See* Maryland-Nat'l Capital Park and Planning Comm'n v. United States Postal Serv., 407 F.2d 1029, 1040 n.10 (D.C. Cir. 1973) (government required to bear burden of proving decision not to file EIS justified because project effects significant). When, however, the plaintiff challenges the *adequacy* of an EIS in a domestic context, courts generally require the plaintiff to establish by a preponderance of the evidence that the EIS does not fulfill NEPA's mandate. *See* Isle of Hope Historical Ass'n v. Army Corps of Eng'rs, 646 F.2d 215, 220 (5th Cir. 1981) (per curiam) (plaintiff required to establish inadequacy of EIS by preponderance of evidence); Monroe County Conservation Council, Inc. v. Adams, 566 F.2d 419, 422 (2d Cir. 1977) (same), *cert. denied*, 435 U.S. 1006 (1978). At least one circuit requires a plaintiff challenging the adequacy of an EIS to raise a substantial environmental issue sufficient to warrant shifting the burden of proof. Winnebago Tribe v. Ray, 621 F.2d 269, 271 (8th Cir. 1980).

Ideally, courts would place the burden of proof on the government in both foreign and domestic challenges to the sufficiency of an EIS because of their recognition of the high value placed on environmental considerations by NEPA. Only agencies have the funds and staff necessary to make a proper environmental assessment and to support that decision by a preponderance of the evidence if the decision is later challenged. *Id.* at 1334-35. Neither the public nor the Congress has sufficient skills or resources to ensure that NEPA's mandate is carried out. *Id.* at 1335. These problems are accentuated in a foreign context. First, the risk of making decisions with insufficient knowledge is greater in a foreign context because there is a lack of information due to the remoteness of the project and because the quality of the information received may not be of the quality the agency customarily receives. As noted by Judge Robinson, the level of expertise of a foreign nation's regulatory bodies may not even begin to approach the level of expertise of United States agencies. *NRDC*, 647 F.2d at 1380 (Robinson, J., concurring). Second, the agency has a far greater opportunity to compile the necessary information in a foreign context because it has some contact with the foreign nation that the typical citizen or congressman lack. Thus, after a prima facie showing of significant environmental effects, the courts should shift the burden of proving compliance to the government.

175. The NRC made no effort to evaluate the environmental effects potentially arising in the Philippines. In addition, the NRC explained that sovereignty constraints on the agency's ability to collect data from within a foreign nation justified its failure to evaluate site-specific effects on the global commons. 647 F.2d at 1353. The agency therefore relied on generic analyses and information collected by the executive branch. *Id.* The NRC, however, was never required to make a showing that it had made a good faith attempt to obtain the information needed to prepare a site-specific EIS. Moreover, according to the petitioners, one of the generic statements relied on by the NRC had been declared outdated and inadequate to support the decisions in the *NRDC* case. Brief, *supra* note 8, at 80. Another statement expressly stated it was not applicable to decisions involving land-based nuclear power plants. *Id.* Finally, a third statement contained an admission that a detailed environmental analysis had not yet been prepared. *Id.* at 80-81.

176. Flint Ridge Dev. Co. v. Scenic Rivers Ass'n, 426 U.S. 776, 787 (1976).

foreign setting recognizes the need to fulfill the mandate of NEPA while still respecting the sovereignty of a foreign nation.

R. David Kitchen

Re-examining the Use of Drug-Detecting Dogs Without Probable Cause

United States v. Beale, 674 F.2d 1327 (9th Cir. 1982)

On April 17, 1980, Detective Berks of the Broward County, Florida, Sheriff's Department observed John Beale and Joseph Pulvano as they arrived together at the Fort Lauderdale Airport.[1] Beale and Pulvano checked their luggage and then separated before independently obtaining seat assignments on a flight to San Diego.[2] They then sat together in the boarding area.[3] Noting what he considered to be suspicious behavior,[4] Detective Berks approached the two men and identified himself.[5] After explaining to the men that they were not under arrest,[6] Detective Berks asked Beale and Pulvano a few questions,[7] thanked them for their co-operation and walked away.[8]

Detective Berks then proceeded to the baggage area with another officer and "Nick," an experienced and reliable drug-detecting dog.[9] Nick sniffed the suspects' luggage and signaled that Beale's suitcase contained a controlled substance.[10] Berks relayed this information to the authorities in Houston, where Beale and Pulvano were scheduled to change planes, and to San Diego, their final destination.[11] In the San Diego airport, "Duster," another trained dog, also indicated that Beale's suitcase contained narcotics.[12] Beale and Pulvano were arrested as they attempted to leave the airport.[13] The officers then ob-

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1. United States v. Beale, 674 F.2d 1327, 1328 (9th Cir. 1982).
2. *Id.*
3. *Id.*
4. *Id.* The following conduct caused Detective Berks to suspect that Beale and Pulvano were drug couriers: separating once inside the airport, obtaining separate seat assignments, looking about furtively, and travelling to a known center of drug traffic. *Id.* at 1328 n.1.
5. *Id.* at 1328.
6. *Id.*
7. *Id.* at 1328-29. Detective Berks asked the two men for some identification. *Id.* Beale complied, but Pulvano said that his identification was in his luggage. *Id.* at 1329. Detective Berks then asked if either of them had ever been arrested. *Id.* Pulvano, appearing nervous, responded that he had been arrested six years earlier on a narcotics charge. *Id.* A computer check later revealed that Pulvano had been arrested and convicted of possessing a large quantity of cocaine six months earlier in an Atlanta airport. *Id.*
8. *Id.* Within minutes after the initial questioning, Pulvano, visibly anxious, approached Detective Berks and asked if anything was wrong. *Id.* Detective Berks replied that there was no problem at that time. *Id.*
9. *Id.*
10. *Id.* A trained dog usually signals to its handler that it has detected a controlled substance by snarling, barking, whining, or pawing at the source of the scent. Comment, *United States v. Solis: Have the Government's Supersniffers Come Down with a Case of Constitutional Nasal Congestion?*, 13 SAN DIEGO L. REV. 410, 415 (1976) [hereinafter *Supersniffers*]. A dog's signal is either "true," meaning that the contraband is in the container, or "dead," meaning that only the odor and not the contraband is present. *Id.* For a general discussion of how dogs are trained to detect narcotics, see *Supersniffers*, *supra*.
11. *Beale*, 674 F.2d at 1329.
12. *Id.*
13. *Id.* Upon arrival in San Diego, Beale quickly exited from the airport without claiming his bags, but was stopped by agents. *Id.* When asked about his luggage, Beale stated that he had lost his claim checks. *Id.* Pulvano was arrested as he started to leave the airport. *Id.* Following the arrests of the two men, Duster indicated that the shoulderbag that Beale had carried on the plane also contained narcotics. *Id.*

tained a search warrant for Beale's luggage.[14] The subsequent search uncovered 961 grams of cocaine and 137 grams of marijuana.[15]

The trial court denied Beale's motion to suppress the cocaine discovered in his luggage.[16] He was subsequently convicted of possession with intent to distribute, and conspiracy to possess with intent to distribute a controlled substance.[17] On appeal, Beale contended that the use of a dog to sniff his luggage in the Fort Lauderdale airport constituted an illegal search under the fourth amendment.[18] The United States Court of Appeals for the Ninth Circuit agreed that the use of a dog to sniff luggage for contraband is a search for fourth amendment purposes, but held that such a search is reasonable if based on articulable suspicion.[19] The court remanded the case to the district court to determine whether Detective Berks had articulable suspicion to conduct the "sniffing expedition."[20]

Judge Ely, writing for the Ninth Circuit, began his analysis of the constitutionality of dog-sniff searches with the premise that the fourth amendment protects people, not places, from unreasonable governmental intrusions into their legitimate expectations of privacy.[21] Recognizing that travelers have a legitimate expectation of privacy in luggage,[22] the court concluded that because a dog detects molecules that are beyond human perception as those molecules emanate from luggage, it intrudes into the "owner's privacy interest in the contents of the container."[23]

The court nonetheless determined that a dog sniff of an individual's luggage does not constitute a sufficient intrusion to invoke the full rigors of the fourth amendment.[24] A dog-sniff search, the court held, does not violate the fourth amendment if based on an officer's "founded" or "articulable" suspicion.[25] Ac-

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14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.* at 1330. The fourth amendment provides that:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. CONST. amend. IV.

19. *Beale*, 674 F.2d at 1335. The district court determined that a dog sniff is not a search under the fourth amendment and hence did not determine whether the officers had articulable suspicion at the time of the search. *Id.* at 1330.

20. *Id.* at 1336. Beale also argued that the initial questioning by Berks in the Florida airport constituted a seizure under the fourth amendment requiring "founded" suspicion or probable cause. *Id.* at 1329. The Ninth Circuit affirmed the lower court's conclusion that Beale had not been seized. *Id.* at 1329-30. The Ninth Circuit noted that Beale and Pulvano had answered the questions "in a spirit of apparent cooperation," that their mobility had not been impaired, and that the encounter had not been a coercive situation. *Id.*

21. *Id.* at 1331 (citing Katz v. United States, 389 U.S. 347, 351 (1967) and United States v. Chadwick, 433 U.S. 1, 7 (1977)).

22. *Beale*, 674 F.2d at 1331. The *Beale* court cited the Supreme Court's decision in Arkansas v. Sanders, 442 U.S. 753, 762 (1979) ("luggage is a common repository for one's personal effects, and therefore is inevitably associated with the expectation of privacy") and United States v. Chadwick, 433 U.S. 1, 11 (owner has privacy interest in contents of footlocker). 674 F.2d at 1331.

23. *Beale*, 674 F.2d at 1333-34.

24. *Id.* at 1334.

25. *Id.* at 1335.

cording to the court, trained dogs are rarely mistaken and detect only the presence of contraband in luggage.[26] Thus, sniff searches merit less restrictive fourth amendment treatment than do other types of searches because they involve minimal and highly discriminate invasions of privacy.[27]

The Ninth Circuit's holding that a dog sniff constitutes a search creates a split in the circuits. Other circuit courts have followed the lead of the Second Circuit[28] in holding that the use of trained dogs to detect contraband in luggage at airports does not constitute a search and thus does not violate the fourth amendment.[29]

This comment analyzes the Ninth Circuit's holding in *Beale* that the use of dogs to sniff luggage for controlled substances[30] is a search permissible under the fourth amendment if based upon articulable suspicion.[31] First, the comment discusses the *Beale* court's determination that a dog sniff constitutes a search under the fourth amendment. The comment agrees with the court's conclusion that there is a reasonable expectation of privacy in personal luggage transported by plane, and examines why a dog sniff is sufficiently intrusive to constitute a search under the fourth amendment. Second, the comment reviews the Ninth Circuit's decision to apply an articulable suspicion standard to dog-sniff searches and argues that this standard is insufficient to protect

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26. *Id.* at 1334.

27. *Id.*

28. *See* United States v. Bronstein, 521 F.2d 459, 462 (2d Cir. 1975) (use of dogs to sniff luggage not search), *cert. denied*, 424 U.S. 918 (1976).

29. *See, e.g.,* United States v. Goldstein, 635 F.2d 356, 361 (5th Cir.) (dog sniff of luggage for narcotics at airport not search), *cert. denied*, 452 U.S. 962 (1981); United States v. Klein, 626 F.2d 22, 27 (7th Cir. 1980) (same); United States v. Sullivan, 625 F.2d 9, 13 (4th Cir. 1980) (same), *cert. denied*, 450 U.S. 923 (1981); United States v. Race, 529 F.2d 12, 14 n.2 (1st Cir. 1976) (dog sniff of freight in airport warehouse raises no fourth amendment issue); *cf.* United States v. Burns, 624 F.2d 95, 101 (10th Cir.) (dog sniff of luggage in hotel room following arrest in room not search), *cert. denied*, 449 U.S. 954 (1980); United States v. Fulero, 498 F.2d 748, 749 (D.C. Cir. 1974) (dog sniff of footlocker at bus depot not search).

Many state courts have also held that the use of dogs to sniff luggage is not a fourth amendment search. *See, e.g.,* State v. Morrow, 128 Ariz. 309, 312, 625 P.2d 898, 901 (1981) (dog sniff of luggage at airport not search); People v. Mayberry, 31 Cal. 3d 335, 341, 644 P.2d 810, 814, 182 Cal. Rptr. 617, 621 (1982) (same); State v. Mosier, 392 So. 2d 602, 605 (Fla. Dist. Ct. App. 1981) (same); State v. Groves, 649 P.2d 366, 372 (Hawaii 1982) (same); People v. Price, 54 N.Y.2d 557, 561, 431 N.E.2d 267, 269, 446 N.Y.S.2d 906, 908 (1981) (same); State v. Wolohan, 23 Wash. App. 813, 820, 598 P.2d 421, 425 (1979) (dog sniff of parcel at bus depot not illegal search); *cf.* State v. Kaiser, 91 N.M. 611, 613, 577 P.2d 1257, 1259 (N.M. Ct. App. 1978) (implying that dog sniff at door of roomette on train not search); State v. Rogers, 43 N.C. App. 475, 480, 259 S.E.2d 572, 576 (1979) (dog sniff of safe deposit box in bank for contraband not search).

A few courts have held that dog sniffs are searches. *See* People v. Evans, 65 Cal. App. 3d 924, 933, 134 Cal. Rptr. 436, 441 (1977) (dog sniffs of compartments at warehouse constitute general exploratory search in violation of fourth amendment); State v. Elkins, 47 Ohio App. 2d 307, 311, 354 N.E.2d 716, 718-19 (1976) (dog sniff of package at airport is search). Some concurring and dissenting judges have agreed with this position. *See* United States v. Bronstein, 521 F.2d 459, 464 (2d Cir. 1975) (Mansfield, J., concurring) (dog sniff of luggage is search), *cert. denied*, 424 U.S. 918 (1976); People v. Price, 554 N.Y.2d 557, 565, 431 N.E.2d 267, 271, 446 N.Y.S.2d 906, 910 (1981) (Meyer, J., concurring) (same); State v. Wolohan, 23 Wash. App. 813, 824, 598 P.2d 421, 427 (1979) (McIntruff, J., dissenting) (dog sniff of parcel at bus depot is search).

30. The scope of this comment is limited to examining the use of trained dogs to sniff luggage at airports for contraband. Trained dogs are also used in other settings, such as schools. *See* Doe v. Renfrow, 475 F. Supp. 1012, 1022 (N.D. Ind. 1979) (use of dog to detect contraband in school not a search), *modified per curiam*, 631 F.2d 91 (7th Cir. 1980), *cert. denied*, 451 U.S. 1022 (1981). The fourth amendment issues presented in those contexts are beyond the scope of this comment.

31. *Beale*, 674 F.2d at 1335.

fourth amendment rights. The comment suggests that probable cause is the proper standard, and explores the effect that the application of a probable cause standard would have on the use of sniff searches. The comment concludes that the Ninth Circuit's application of an articulable suspicion standard conflicts with Supreme Court precedent, and that the need to preserve fourth amendment rights and provide understandable guidelines for police conduct requires that dog-sniff searches be supported by probable cause.

I. IS A DOG SNIFF A SEARCH?

A. THE PRIVACY INTEREST IN LUGGAGE

The Ninth Circuit began its analysis by examining whether Beale had a legitimate expectation of privacy in his luggage.[32] The court's analysis rested on two Supreme Court decisions, *United States v. Chadwick*[33] and *Arkansas v. Sanders*.[34] *Chadwick* involved the warrantless search of a 200 pound double-locked footlocker.[35] The Court reasoned that the defendants' privacy interests in the footlocker entitled them to the protection of the fourth amendment's warrant requirement.[36] In disallowing the search, the Court noted that "luggage is intended as a repository of personal effects."[37] Accordingly, the Court stated that "[b]y placing personal effects inside a double-locked footlocker, [the owners] manifested an expectation that the contents would remain free from public examination," an expectation protected by the fourth amendment.[38] The Supreme Court reaffirmed *Chadwick* two years later in *Arkansas v. Sanders*.[39] In *Sanders* the Court invalidated the warrantless search of an unlocked suitcase, emphasizing that luggage "is inevitably associated with the expectation of privacy"[40] because it is used to transport personal possessions during travel.[41]

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32. *Id.* at 1330-32.

33. 433 U.S. 1 (1977).

34. 442 U.S. 753 (1979).

35. *Chadwick*, 433 U.S. at 3-5. In *Chadwick*, federal narcotics agents in Boston were notified that two men were transporting a suspicious footlocker by train to Boston. *Id.* at 3. The agents watched the men leave the train and claim the footlocker. *Id.* The agents did not arrest the suspects until a trained drug-detecting dog confirmed their suspicions that the footlocker contained narcotics and the men had loaded the footlocker into a car. *Id.* at 4. Following the arrest, the agents conducted a warrantless search of the footlocker and discovered a large quantity of marijuana. *Id.* at 4-5.

36. *Id.* at 15-16.

37. *Id.* at 13.

38. *Id.* at 11.

39. 442 U.S. at 766. In *Sanders*, police officers, having received a tip that the defendant would be transporting marijuana in a suitcase by plane, watched the defendant leave the airport, enter a cab, and drive away. *Id.* at 755. The police subsequently stopped the cab, opened the trunk, and searched the defendant's unlocked suitcase, discovering a quantity of marijuana. *Id.*

40. *Id.* at 762.

41. *Id.* at 764.

Last term, in United States v. Ross, 456 U.S. 798 (1982), the Supreme Court again discussed the propriety of warrantless searches of containers. *Ross* involved the warrantless search of a paper bag and leather pouch found during the warrantless search of a car. *Id.* at 2160. The Court rejected the suggestion in *Sanders* that a warrantless search of an automobile could never extend to a warrantless search of a container found in the car. *Id.* at 2172. According to the *Ross* Court, police with probable cause to search an automobile may search any part of the vehicle and any container that may conceal the object of their search. *Id.*

Ross should not be read, however, as diminishing the expectations of privacy that attach to luggage

Basing its analysis on the privacy notions set forth in *Chadwick* and *Sanders*, the Ninth Circuit considered whether an individual has an "inevitable" and "inherent" interest in keeping the contents of his luggage private.[42] The court stated that any person who places personal effects in a suitcase seeks to shield them from the public and thus manifests an expectation that the contents will remain private.[43] Once an individual closes his luggage, the court noted, his enclosed belongings are entitled to the same fourth amendment protection accorded private residences.[44]

The Ninth Circuit did not adopt the argument made by other courts[45] that an airline traveler has a lessened expectation of privacy because the traveler knows that his luggage will be handled by airline employees and searched for dangerous items. Practical considerations support the *Beale* court's rejection of that line of reasoning. Although the owner of checked baggage knows that its exterior will be exposed to public observation and that it will be handled, that knowledge does not disturb the expectation that the contents will not be communicated to the public. Furthermore, the checking of luggage is often a physical necessity; all luggage which is too large to be carried on the plane must be checked. The traveler, therefore, should not be held to have voluntarily relinquished his expectation of privacy simply because he has checked his luggage.[46] Privacy expectations do not diminish as a person becomes further removed from his belongings, just as one does not lose his expectation of privacy in his home when he is away from it.[47] Similarly, a passenger who con-

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transported by plane. The *Ross* Court expressly affirmed the holding in *Sanders* that a warrantless search of a suitcase unreasonably intrudes upon the expectation of privacy in luggage. *Id.*

The *Ross* decision is best understood as an extension of the automobile exception to the warrant requirement, and not as a retreat from the Court's recognition of a legitimate expectation of privacy in luggage. *See id.* at 2161-62 (Court granted certiorari to clarify the scope of automobile exception).

42. *Beale*, 674 F.2d at 1331.

43. *Id.* at 1334 (citing Katz v. United States, 389 U.S. 347, 352 (1967)). In *Katz*, FBI agents had attached an electronic listening device to the outside of the public telephone booth that Katz used to place calls. 389 U.S. at 348. The Supreme Court held that this electronic surveillance violated the fourth amendment, even though there had been no physical penetration of the phone booth. *Id.* at 353, 359. The *Katz* decision marked a turning point in fourth amendment analysis: the Supreme Court interpreted the fourth amendment to protect the privacy interests of individuals, and not just specific "constitutionally protected areas." *Id.* at 350.

44. *Beale*, 674 F.2d at 1332. The court stated: "No less than one who locks the doors of his home against intruders, one who safeguards his personal possessions [by locking them in a piece of luggage] is due the protection of the Fourth Amendment Warrant Clause." *Id.* (quoting Chadwick v. United States, 433 U.S. 1, 11 (1977)).

45. State v. Coleman, 412 So. 2d 532, 535 (La. 1982) (once luggage is in custody of airline, no reasonable expectation exists that it will not be inspected from exterior by airline and police officers); United States v. Sullivan, 625 F.2d 9, 13 (4th Cir. 1980) (no reasonable expectation of privacy because any passenger's bags may be examined to protect public), *cert. denied*, 450 U.S. 923 (1981); United States v. Bronstein, 521 F.2d 459 (2d Cir. 1975) (Mansfield, J., concurring) (expectation of privacy in luggage located in common baggage area less than expectation of privacy in bagage carried by person), *cert. denied*, 424 U.S. 918 (1976).

46. If the traveler voluntarily relinquished all control over his luggage, then the question whether the property had been abandoned would arise. *Cf.* Hester v. United States, 265 U.S. 57, 58 (1924) (no fourth amendment seizure when officers examined contents of abandoned container).

47. *Cf.* State v. Wolohan, 23 Wash. App. 813, 820 n.5, 598 P.2d 421, 425 n.5 (1979) (court entertained grave doubts whether rationale of limited expectation of privacy when parcel was separate from owner would apply to similar search of carry-on luggage in public waiting room); *But see Bronstein*, 521 F.2d at 465 (Mansfield, J., concurring) (property carried by person enjoys more privacy than baggage consigned to common baggage area). The *Beale* court recognized that the expectation of privacy in the luggage does not depend on the owner's presence, but pointed out that an additional constitutional

sents to have his luggage checked electronically for hazardous contents reasonably expects that the security search will reveal only certain items, such as metal objects and weapons, while others will escape detection. Although it did not address these arguments explicitly, the *Beale* court held that an airline traveler could reasonably expect that the contents of his luggage, including narcotics, would remain private and "that a trained canine [would] not broadcast its incriminating contents to the authorities."[48]

The Ninth Circuit also rejected an argument that a person has no reasonable expectation of privacy when his conduct is criminal.[49] According to that view, because the dog sniff only discloses the presence of contraband and because a traveler can have no expectation of privacy in contraband, the use of dogs to sniff luggage does not intrude upon any protected privacy expectation.[50] This argument is based on a misconception of fourth amendment analysis, which should focus not on whether the search reveals contraband, but on whether the search intrudes upon a protected privacy interest in discovering the presence of contraband. The Supreme Court has ruled that it is the privacy interest in the area searched, not the possessory interest in the item that is disclosed, that permits a fourth amendment challenge.[51] The *Beale* court cited *United States v. Taborda*,[52] in which the Second Circuit determined that the reasonableness of a privacy expectation depends on the degree to which the activity is viewable to the public and not on the degree to which the activity is criminal.[53] *Taborda* recognized that if the constitutionality of police investigations depends upon a subsequent determination of the criminality of the observed conduct, then it will be impossible to create workable conduct guidelines for the police.[54] The *Beale* court, therefore, was correct to ask only whether Beale had an expectation of privacy in his luggage that was intruded on by the dog sniff.

The Ninth Circuit's holding that Beale had a protectable privacy interest in his luggage marks a major break from the prevailing view in other federal courts.[55] The Second Circuit ruled in *United States v. Bronstein*[56] that there

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problem would arise if the owner's personal privacy was intruded upon in the course of a dog sniff of his luggage. *Beale*, 675 F.2d at 1335 n.19. The court stated that "the use of dogs to sniff people, rather than objects, is highly intrusive and is normally inconsistent with the concepts embodied in our Constitution." *Id.* at 1336 n.20.

48. *Beale*, 674 F.2d at 1334. *See also* Case Comment, *Search and Seizure—Marijuana Sniffing Dogs:* United States v. Bronstein, 42 MO. L. REV. 331, 334 (1977) (individual has reasonable expectation of privacy when physical barrier shields object searched from normal sense perception) [hereinafter *Search and Seizure*].

49. *Beale*, 674 F.2d at 1334 n.13 (determination of constitutional protection afforded expectations of privacy is not aided by reference to conduct involved).

50. The *Beale* court, without expressly delineating this argument, dismissed it in a footnote. *Id.*

51. *See* United States v. Salvucci, 448 U.S. 83, 93 (1980) (fourth amendment applies when defendant had an expectation of privacy in area searched, not merely when defendant had possessory interest in items seized). *See also* Rawlings v. Kentucky, 448 U.S. 98, 105-06 (1980) (without showing expectation of privacy in area searched, defendant's assertion of ownership of items seized insufficient to invoke fourth amendment protections); Rakas v. Illinois, 439 U.S. 128, 148 (1979) (defendants could not invoke fourth amendment protections when they failed to show property or possessory interest in items seized or expectation of privacy in area searched).

52. 635 F.2d 131 (2d Cir. 1980).

53. *See id.* at 138 n.10 (reasonableness of privacy expectation depends on degree activity is viewable by public without visual aids).

54. *Id.*

55. *See supra* note 29 (citing cases holding that use of dogs to sniff luggage or other items is not search).

56. 521 F.2d 459 (2d Cir. 1975), *cert. denied*, 424 U.S. 918 (1976).

can be no expectation of privacy when one transports baggage by plane, particularly because airports are compelled to scrutinize luggage to ensure public safety.[57] Similarly, in *United States v. Fulero*[58] the District of Columbia Circuit dismissed as frivolous the argument that a dog sniff of a footlocker at a bus depot violated the fourth amendment, apparently rejecting any recognition of a privacy interest.[59] Because these cases were decided before *Chadwick* and *Sanders*, it is questionable whether their holdings should be followed.[60] More recent decisions, however, have failed to appreciate the significance of *Chadwick* and *Sanders* in the context of dog sniffs for narcotics.[61] For example, the Fourth Circuit in *United States v. Sullivan*[62] failed altogether to discuss these Supreme Court cases; instead, it followed *Bronstein*, stating that a passenger has no legitimate expectation of privacy in his luggage when it may be inspected for safety purposes.[63] Such a conclusion, however, seems doubtful in light of the great emphasis which *Chadwick* and *Sanders* placed on the expectation of privacy inherent in luggage. The *Beale* court correctly took account of these decisions.

B. A DOG SNIFF INTRUDES UPON THE PRIVACY INTEREST IN LUGGAGE

The Ninth Circuit held that the use of a dog to sniff the air around Beale's suitcase intruded upon Beale's privacy interest in his luggage and thus constituted a search subject to fourth amendment protection.[64] The court character-

57. *Id.* at 462. The Second Circuit continues to hold that the use of dogs to sniff luggage for narcotics is not a fourth amendment search. United States v. Waltzer, 682 F.2d 370, 373 (2d Cir. 1982). In *Waltzer*, the Second Circuit applied a different rationale than that employed in *Bronstein* to support its conclusion; the court conceded that individuals have a privacy interest in their luggage (mentioning *Chadwick* and *Sanders*), but maintained that there is still no intrusion on this privacy interest by dog sniffs because the odor detected is extrinsic to the luggage. *Id.* The *Beale* court was responding to the pre-*Chadwick* decision of the *Bronstein* court. In effect, however, the *Beale* opinion responds to both Second Circuit opinions by rejecting the Second Circuit's continuing view that a dog sniff does not intrude upon any privacy interests.

58. 498 F.2d 748 (D.C. Cir. 1974) (per curiam).

59. *Id.* at 749.

60. *See Beale*, 674 F.2d at 1330-31 (reasoning employed in *Bronstein* and *Fulero* does not survive *Chadwick* and *Sanders*).

61. The federal courts, in decisions that post-date *Chadwick* and *Sanders*, have ignored these Supreme Court decisions in their analysis of dog-sniff searches. *See, e.g.*, United States v. Goldstein, 635 F.2d 356 (5th Cir.), *cert. denied*, 452 U.S. 962 (1981); United States v. Sullivan, 625 F.2d 9 (4th Cir. 1980), *cert. denied*, 450 U.S. 923 (1981). Only the Second Circuit in response to the *Beale* decision explicitly distinguishes *Chadwick* and *Sanders* in its analysis. United States v. Waltzer, 682 F.2d 370, 373 (2d Cir. 1982). *But see* United States v. Klein, 626 F.2d 22, 26 (7th Cir. 1980) (stating that dog sniff does not violate *Sanders* mandate).

62. 625 F.2d 9 (4th Cir. 1980), *cert. denied*, 450 U.S. 923 (1981).

63. *Id.* at 13.

64. *Beale*, 674 F.2d at 1333-34. In general, a search is an attempt by the police to uncover evidence of a crime. *See* Marshal v. United States, 422 F.2d 185, 189 (5th Cir. 1970) (search is "probing, exploratory quest for evidence of crime"); United States v. Johnson, 431 F.2d 441, 445 (5th Cir. 1970) (en banc) (search implies examination of person or property to discover evidence of crime for use in prosecution) (Godbold, J., dissenting).

Several commentators also have argued that the use of dogs to detect contraband is a search. *See, e.g.*, Note, *Constitutional Limitations on the Use of Canines to Detect Evidence of Crime*, 44 FORDHAM L. REV. 973, 990 (1976) (suggesting that use of any aid which "improves, enhances or replaces the natural senses of an officer is a search") [hereinafter *Constitutional Limitations*]; *Search and Seizure*, *supra* note 48, at 334 (dog sniff intrudes upon privacy in luggage and constitutes search); *Supersniffers*, *supra* note

ized the trained dog as an "independent detection device"[65] that alerted the officer to information he would not have been able to detect with his own senses.[66] The court concluded that the detection intruded upon Beale's expectation of privacy in the contents of his luggage, thus implicating the fourth amendment's prohibition against unreasonable searches.[67]

In reaching this conclusion, the Ninth Circuit responded to an argument accepted by other courts that a dog sniff does not intrude upon a traveller's expectation of privacy.[68] Although not discussed by the *Beale* court,[69] in *United States v. Goldstein*,[70] the Fifth Circuit argued that if an officer smelled the odor of narcotics emanating from the luggage, there would be no intrusion on privacy interests.[71] No fourth amendment search would occur because the fourth amendment does not protect "what a person knowingly exposes to the public."[72] The *Goldstein* court reasoned that detection of the odor by a dog is no different for fourth amendment purposes than detection of the odor by an officer.[73] The Fifth Circuit, therefore, concluded that the use of a dog to sniff for contraband is not a fourth amendment search because it does not intrude upon any legitimate expectation of privacy.[74]

The *Beale* court referred to the type of approach used in *Goldstein* as a "variant of human plain view or plain smell."[75] Under the plain view doctrine, no search occurs if the evidence of a crime is fully exposed to the public when discovered. The plain view doctrine applies to situations in which an officer detects evidence of crime through his own senses without physically intruding into a constitutionally protected area.[76] Because reasonable expectations of privacy do not exist with respect to items exposed to the public, there can be no

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10, at 426 (use of dogs to sniff areas where persons have reasonable expectations of privacy should be called search).

65. *Beale*, 674 F.2d at 1333.

66. *Id.*

67. *Id.* at 1334. The court concluded that "[o]ne who reposes his personal effects, including contraband, in a locked suitcase is surely entitled to assume that a trained canine will not broadcast its incriminating contents to the authorities." *Id.*; *see also Bronstein*, 521 F.2d at 464 (Mansfield, J., concurring) (dog-sniff search is intrusion into area which owner is entitled to enjoy as private).

68. *See, e.g.*, United States v. Goldstein, 635 F.2d 356, 361 (5th Cir.) (privacy interest does not extend to airspace surrounding luggage), *cert. denied*, 452 U.S. 962 (1981); People v. Price, 54 N.Y.2d 557, 561, 431 N.E.2d 267, 269, 446 N.Y.S.2d 906, 909 (1981) (same); State v. Wolohan, 23 Wash. App. 813, 818, 598 P.2d 421, 424 (1979) (no reasonable expectation of privacy in airspace surrounding package).

69. The *Beale* court set forth its argument as a general proposition rather than as a response to a particular court. *See Beale*, 674 F.2d at 1332-34.

70. 635 F.2d 356 (5th Cir.), *cert. denied*, 452 U.S. 962 (1981).

71. *Id.* at 361.

72. Katz v. United States, 389 U.S. 347, 351 (1967).

73. *Goldstein*, 635 F.2d at 361; *see also Bronstein*, 521 F.2d at 461 (dog sniff of luggage no different for fourth amendment purposes than officer's own detection of odor).

74. *Goldstein*, 635 F.2d at 361.

75. *Beale*, 674 F.2d at 1333. The cases that the Ninth Circuit cites for the plain smell doctrine involved situations in which an officer detected an odor in a public place. *See* United States v. Johnston, 497 F.2d 397, 398 (9th Cir. 1974) (agent's bending over to sniff luggage in vestibule area of train not a search); United States v. Barron, 472 F.2d 1215, 1217 (9th Cir. 1972) (per curiam) (agent's detection of marijuana odor in car provided probable cause for search), *cert. denied*, 413 U.S. 920 (1973); United States v. Leazar, 460 F.2d 982, 984 (9th Cir. 1972) (police officer's detection of marijuana odor in car provided probable cause for arrest).

76. Harris v. United States, 390 U.S. 234, 236 (1968) (per curiam); 1 W. LAFAVE, SEARCH AND SEIZURE: A TREATISE ON THE FOURTH AMENDMENT 242 (1978).

fourth amendment search in such situations.[77] The open view doctrine, which is closely related to the plain view doctrine, authorizes the police to gather evidence that is found in the open as opposed to evidence that is inside an individual's house, among his belongings, or on his person.[78] The open view doctrine is based on the principle that the protections of the fourth amendment do not extend to what a person knowingly exposes to the public in the "open fields."[79] Courts have broadened the two doctrines to allow law enforcement officers to use certain sense-enhancing devices, such as binoculars[80] and flashlights,[81] without triggering fourth amendment protections.[82] In contrast, the detection of contraband by independent detection devices which replace rather than enhance human senses, such as x-ray scans[83] and magnetometers,[84] does not fall within the purview of either the plain view or open view doctrine.[85]

In essence, the courts that hold that a dog sniff is not a fourth amendment search regard dogs as tools that enhance the officer's own ability to detect the odor of contraband under the plain smell doctrine.[86] The *Beale* court, how-

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77. 1 W. LAFAVE, *supra* note 76, at 243.

78. *See* Moylan, *The Plain View Doctrine: Unexpected Child of the Great "Search Incident" Geography Battle*, 26 MERCER L. REV. 1047, 1097 (1975) (police officer may seize evidence in open view in a constitutionally non-protected area).

79. Hester v. United States, 265 U.S. 57, 59 (1924).

80. *See* United States v. Allen, 633 F.2d 1282, 1290-91 (9th Cir. 1980) (use of binoculars from hill observation site not a search), *cert. denied*, 454 U.S. 833 (1981); United States v. Minton, 488 F.2d 37, 38 (4th Cir. 1973) (use of binoculars from nearby embankment did not violate expectation of privacy), *cert. denied*, 416 U.S. 936 (1974). *But see* United States v. Kim, 415 F. Supp. 1252, 1256 (D. Hawaii 1976) (use of 800mm telescope to observe defendant's activities within his home from quarter-mile distance constituted unreasonable visual intrusion).

81. *See* United States v. Johnson, 506 F.2d 674, 676 (8th Cir. 1974) (use of flashlight to view interior of automobile at night falls within plain view exception), *cert. denied*, 421 U.S. 917 (1975); United States v. Hood, 493 F.2d 677, 680 (9th Cir.) (same), *cert. denied*, 419 U.S. 852 (1974).

82. The key factor in these cases is that the sense-enhancing devices only enable the officers to see what they would normally see under ideal conditions. *See generally* Note, *Police Use of Sense-Enhancing Devices and the Limits of the Fourth Amendment*, 1977 U. ILL. L. F. 1167, 1173-83 (discussing cases and rationales for use of flashlights, binoculars and telescopes) [hereinafter *Sense-Enhancing Devices*].

83. *See* United States v. Henry, 615 F.2d 1223, 1227 (9th Cir. 1980) (use of x-ray scan at airport is search).

84. *See, e.g.*, United States v. Albarado, 495 F.2d 799, 806 (2d Cir. 1974) (use of magnetometer in airport to detect weapons a search); United States v. Cyzewski, 484 F.2d 509, 512 (5th Cir. 1973) (same), *cert. dismissed*, 415 U.S. 902 (1974).

85. The use of independent detection devices is a search because the contents of the containers searched are not open to public view. *See Sense-Enhancing Devices*, *supra* note 82, at 1195 (magnetometer intrudes upon passenger's privacy by disclosing presence of concealed metal objects). A warrantless search by an independent detection device may sometimes be justified under an exception to the warrant requirement other than the plain view doctrine. *See infra* note 125 (discussing administrative searches in airports).

86. Several courts have analyzed dog sniffs under the plain view or plain smell doctrine. *See, e.g.*, United States v. Goldstein, 635 F.2d 356, 361 (5th Cir.) (agent's use of own or trained dog's nose not a search), *cert. denied*, 452 U.S. 962 (1981); United States v. Bronstein, 521 F.2d 459, 461 (2d Cir. 1975) (same), *cert. denied*, 424 U.S. 918 (1976); State v. Wolohan, 23 Wash. App. 2d 813, 820, 598 P.2d 421, 425 (1979) (sniffing comes within "plain smell" doctrine).

Other courts and commentators have rejected the argument that dog sniffs can be justified under the plain view doctrine. *See Bronstein*, 521 F.2d at 465 (Mansfield, J., concurring) (use of dog sniff, like hidden microphone, replaces agents' senses and results in search); State v. Elkins, 47 Ohio App. 2d 307, 311, 354 N.E.2d 716, 718 (1976) (dog detects something "entirely hidden from human senses"). *See also* Gardner, *Sniffing for Drugs in the Classroom—Perspectives on Fourth Amendment Scope*, 74 NW. U.L. REV. 803, 839-41 (1980) (plain view exception justifies inadvertent discovery of evidence, not initial intrusion leading to discovery) [hereinafter *Drugs in the Classroom*]; Note, *Search and Seizure:*

ever, classified the olfactory powers of dogs as an independent detection device.[87] The officer does not discover a substance through enhancement of his own senses when he relies upon a trained dog, whose olfactory powers can be more than eight times as strong as those of a human being.[88] Because the officer does not detect the odor through his own senses, the odor should not be considered exposed to the public. A reasonable expectation of privacy should, therefore, protect the area from which the odor emanates. Just as the use of other independent detection devices constitutes a fourth amendment search, so too the use of dogs to sniff luggage invades reasonable expectations of privacy. Following this reasoning, the Ninth Circuit concluded that the dog's detection of the contraband cannot be justified under the plain view or open view doctrines, but must instead be considered a search.[89]

The *Beale* court correctly decided that the detection of contraband in Beale's luggage intruded upon his privacy interests even though the dog sniffed only the exterior of the bag.[90] The Supreme Court emphatically rejected the view that physical penetration is a prerequisite to finding a fourth amendment violation in *Katz v. United States*.[91] In *Katz* the Court invalidated the use of a remote electronic surveillance device that monitored conversations in a telephone booth.[92] The Court stated that "once it is recognized that the Fourth Amendment protects people—not simply 'areas'—against unreasonable searches and seizures, it becomes clear that the reach of that amendment cannot turn upon the presence or absence of a physical intrusion into any given enclosure."[93] Instead, the Court stated, the fourth amendment protects "what [a person] seeks to preserve as private, even in an area accessible to the pub-

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The Detection of Marijuana by Trained Dogs, 2 U. DAYTON L. REV. 149, 153 (1977) (same); *Supersniffers*, *supra* note 10, at 423 (drugs not in plain smell of officers; only dog detects them); *Constitutional Limitations*, *supra* note 64, at 988 (lack of inadvertence removes dog sniff from open view doctrine; replacement rather than enhancement of agent's senses removes dog sniff from plain smell doctrine).

87. 674 F.2d at 1333. Although dogs are not machines, they are trained to respond mechanically to certain sensory perceptions, and their reactions approach 100 percent accuracy. *See* People v. Price, 54 N.Y.2d 557, 565, 431 N.E.2d 267, 271, 446 N.Y.S.2d 906, 910 (1981) (Meyer, J., concurring) (no difference between machine electronically sensing sound vibrations and animal sensing odor); *Drugs in the Classroom*, *supra* note 86, at 842-43 (unclear that dogs are less intrusive than machines); *Supersniffers*, *supra* note 10, at 416-18 (trained dog similar to machine); *cf.* United States v. Meyers, 536 F.2d 963, 966 (1st Cir. 1976) (accuracy of dog as informant substantiated by mechanical reactions to certain cues).

88. *Beale*, 674 F.2d at 1333. Conceivably an officer might detect the odor of contraband through his own senses, which would fall within the plain smell variant of the plain view doctrine. Such strong odors, however, are the exception in airport drug transportation cases. In United States v. Viera, 644 F.2d 509 (5th Cir.), *cert. denied*, 454 U.S. 867 (1981), the police thought it necessary to lightly press the suspect's bags with their hands in order to procure a scent strong enough for a trained dog to perceive. *Id.* at 510. The constitutionality of this type of intrusion is questionable as the manipulation of the bag produces a scent which would not otherwise be exposed to the public. In *Viera*, however, the Fifth Circuit concluded that such handling of luggage did not alter the constitutional inquiry. *Id. But see* Hernandez v. United States, 353 F.2d 624, 626 (9th Cir. 1965) (officer's manipulation of bag to procure scent is fourth amendment search), *cert. denied*, 384 U.S. 1008 (1966). In any event, the fact that police resort to manipulation of baggage to produce a scent indicates that agents who happen to be near luggage containing contraband ordinarily cannot detect the scent on their own.

89. *Beale*, 674 F.2d at 1333-35.

90. *Id.* at 1334-35.

91. 389 U.S. 347, 352-53 (1967).

92. *Id.* at 353-59.

93. *Id.* at 353. Prior to *Katz*, the Supreme Court had stated in Olmstead v. United States, 277 U.S. 438 (1928) and Goldman v. United States, 316 U.S. 129 (1942), that a physical penetration of an area was necessary to have a fourth amendment violation. *Katz*, 389 U.S. at 352. The Supreme Court, however, has abandoned the notion that tangible property interests determine the government's author-

lic."[94] Beale had a reasonable expectation that the contents of his luggage would remain private.[95] Thus, the Ninth Circuit correctly concluded that the invasion of his privacy interest by the "intruding canine nose" constituted a search under the fourth amendment.[96]

II. WHAT IS THE PROPER STANDARD TO APPLY TO SNIFF SEARCHES?

A. AN ARTICULABLE SUSPICION STANDARD INADEQUATELY PROTECTS REASONABLE EXPECTATIONS OF PRIVACY

Although the Ninth Circuit correctly concluded that Beale had a privacy interest in his luggage under the fourth amendment, the court failed to fully safeguard this interest. In the court's view, an officer's "founded" or "articulable" suspicion provided adequate fourth amendment protection because the intrusion of the sniff search was minimal.[97]

The Ninth Circuit justified its minimal intrusion/articulable suspicion theory on the ground that "there is no risk that an innocent person's privacy will be intruded upon."[98] This rationale is based primarily on the nature of the intrusion occasioned by the dog sniff. The olfactory powers and training of dogs make sniff searches a highly discriminate tool; the dogs only detect specific types of contraband.[99] Additionally, the dogs are trained so that any error is likely to be a mistake of omission, which favors the suspect.[100]

The *Beale* court's rationale is not persuasive. Implicit in the court's reasoning is the notion that the expectation of privacy of innocent persons should be accorded greater respect than that of guilty persons. The Supreme Court, however, has noted that constitutional guarantees lose meaning if they protect only persons thought to be innocent.[101] In addition, an innocent person errone-

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ity to search and seize. *Id.* at 353. Accordingly, a physical intrusion of property is no longer a prerequisite to a fourth amendment violation. *Id.*

94. *Id.* at 351.

95. *See supra* notes 32-48 and accompanying text (discussing expectation of privacy associated with luggage).

96. *Beale*, 674 F.2d at 1334.

97. *Id.* at 1334-35. The court argued that the "use of drug dogs [was] sufficiently distinct [from] and less intrusive" than x-ray scans and the use of magnetometers to warrant the application of a less demanding standard than probable cause. *Id.* at 1334. The distinction is not self-evident, as all are "non-human means of detecting the contents of a closed area without physically entering into it." United States v. Bronstein, 521 F.2d 459, 464 (2d Cir. 1975) (Mansfield, J., concurring), *cert. denied*, 424 U.S. 918 (1976).

98. *Beale*, 674 F.2d at 1334 (quoting 1 W. LAFAVE, SEARCH AND SEIZURE: A TREATISE ON THE FOURTH AMENDMENT 287 (1978)).

99. *Id.* The court distinguished dog sniffs from x-ray and magnetometer scans, which are considerably less discriminate as to what they reveal. *Id.* Courts have held that x-ray and magnetometer scans constitute searches subject to the requirements of the fourth amendment. *See supra* notes 83-84 (citing cases in which x-ray and magnetometer scans found to be fourth amendment searches). Other electronic surveillance devices also have triggered full fourth amendment protections. *See, e.g.*, Katz v. United States, 389 U.S. 347, 359 (1967) (use of electronic listening device on public phone violates fourth amendment).

100. *Beale*, 674 F.2d at 1334. This mistake of omission "obviat[es] the possibility of annoyance, inconvenience, harassment, and humiliation associated with unproductive surveillance of other sorts." *Id.* at 1334-35 (quoting 1 W. LAFAVE, SEARCH AND SEIZURE: A TREATISE ON THE FOURTH AMENDMENT 288 (1978)).

101. *See* United States v. Calandra, 414 U.S. 338, 357 (1974) (Brennan, J., dissenting) (exclusionary rule protects all potential victims of unlawful government conduct); Weeks v. United States, 232 U.S. 383, 392 (1914) (fourth amendment "protection reaches all alike, whether accused of crime or not").

ously subjected to a dog sniff has no opportunity to object to the invasion of his privacy because he will never know that the invasion has taken place.[102] A lack of awareness should not validate such an intrusion.[103]

The Supreme Court in *Katz* expressly rejected the suggestion that the limited nature of a search justifies the abrogation of fourth amendment standards; a search may not be sustained "upon the sole ground that officers reasonably expected to find evidence of a particular crime and voluntarily confined their activities to the least intrusive means consistent with that end."[104] In *Katz* the government agents confined their electronic surveillance to the brief periods of time during which the suspect used a telephone booth.[105] They took precautions against overhearing the conversations of anyone other than the suspect himself.[106] The Court found that even this limited electronic surveillance violated the fourth amendment.[107]

The limited intrusion in *Katz* presents a situation directly analogous to the one presented in *Beale*. The conclusion in *Katz* that the warrantless electronic surveillance was unconstitutional[108] should have provided more guidance than the *Beale* court recognized. Although the Ninth Circuit relied on *Katz* to conclude that Beale had a protectable privacy interest in his luggage,[109] the court disregarded *Katz* in determining whether the limited intrusion must be based on probable cause. A factual distinction between the two cases is that one involves an electronic device while the other involves an animal. The Ninth Circuit may have been reluctant to equate dogs with machines, but if a dog serves the same function as a mechanical or electronic device,[110] then a court should not invoke factual distinctions to circumvent fourth amendment principles.

The *Beale* court's conclusion that articulable suspicion justifies the dog sniff is also inconsistent with the basis of its determination that a dog sniff is a search.[111] The Ninth Circuit's insistence on the articulable suspicion standard leads to the dilution of constitutional guarantees against which the court itself warned when it insisted that a dog sniff is a search. The court contradicts itself by applying such a permissive standard after emphasizing that a dog search intrudes on the "inherent" and "inevitable" privacy interest a traveler has in

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102. An innocent person will know of the search only if the dog erroneously indicates the presence of contraband.

103. One could not argue persuasively that a search of a home or wiretap is valid as long as no one knows of it. Similarly, a traveler, whether he knows of the search or not, has a legitimate expectation that the contents of his luggage will remain private.

104. *Katz*, 389 U.S. at 356-57; *see also Bronstein*, 521 F.2d at 464 (Mansfield, J., concurring) (discriminate nature of dog sniff not basis for legal distinction).

105. *Id.* at 354. The agents in *Katz* made every effort to restrict the intrusion. The Court noted that the scope and duration of the surveillance was limited to establishing the unlawful content of Katz' communications. *Id.* at 354. On the one occasion when the agents intercepted the statements of someone other than Katz the agents did not listen. *Id.* at 354 n.15.

106. *Id.* at 354.

107. *Id.* at 356-59.

108. *Id.* at 353.

109. *See Beale*, 674 F.2d at 1331-34 ("to paraphrase *Katz*, what Beale sought to exclude when he locked his suitcase was not only the intruding human eye—it was also the intruding canine nose").

110. *See supra* note 87 (discussing similarity between trained dogs and electronic independent detection devices).

111. 674 F.2d at 1332.

the contents of his luggage.[112]

Moreover, trial courts will probably use the drug courier profile[113] to establish articulable suspicion. One court has noted that some aspects of the profile, such as nervous and evasive behavior, are very subjective.[114] Other aspects, such as being the first to disembark from a flight or traveling from a source city, are overbroad.[115] Although the Supreme Court has not spoken definitively on the reliability of the profile,[116] commentators are skeptical of its value.[117] Adoption of an articulable suspicion standard in the context of dog searches allows an officer "engaged in the often competitive enterprise of ferreting out crime"[118] to decide whether to intrude on a traveler's reasonable expectation of privacy based on subjective observations of conduct often characteristic of innocent as well as guilty persons.[119]

The Ninth Circuit broke from the prevailing view by holding that a dog sniff of luggage constitutes a search.[120] The basis for the court's divergence was its belief that travelers have a reasonable expectation of privacy in their luggage.[121] By concluding that an officer's finding of reasonable suspicion overcomes this expectation of privacy, however, the court ignored Supreme Court precedent requiring that warrantless searches be supported by probable cause.[122]

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112. *Id.* at 1331.

113. The Drug Enforcement Agency developed the profile to help agents identify persons attempting to transport narcotics via airlines. Suspects are identified by matching their behavior with various traits associated with drug couriers. Comment, Mendenhall *and* Reid: *The Drug Courier Profile and Investigative Stops*, 42 U. PITT. L. REV. 835, 835-36 (1981). Although the traits in the profile vary from city to city, they usually include the following: 1) the purchase of a ticket with cash; 2) travel from a source city of drugs; 3) travel under an alias; 4) unusual nervousness; 5) leaving a fictitious call-back telephone number with the airline; 6) boarding or disembarking last; and 7) traveling on an early morning flight. *Id.* at 837-39.

Increasingly, law enforcement agents rely on the drug courier profile rather than informants to identify targets for drug-detecting dogs. *See, e.g.,* United States v. Waltzer, 682 F.2d 370, 371-72 (2d Cir. 1982) (behavior consistant with common drug courier behavior attracted agent's attention); United States v. Goldstein, 635 F.2d 356, 358-59 (5th Cir.) (same), *cert. denied*, 452 U.S. 962 (1981); United States v. Klein, 626 F.2d 22, 24-25 (7th Cir. 1980) (same).

114. United States v. Waltzer, 682 F.2d 370, 373 (2d Cir. 1982).

115. *Id.*

116. *See* United States v. Mendenhall, 446 U.S. 544, 547 n.1, 555 (1980) (questioning of suspects whose behavior matched drug-courier profile not a seizure); Reid v. Georgia, 448 U.S. 438, 441 (1980) (per curiam) (characteristics in profile describe large category of innocent travelers).

117. *See Waltzer*, 682 F.2d at 373 (subjectivity and overbreadth of profile have led to judicial skepticism) (citing Reid v. Georgia, 448 U.S. 438 (1980)). *See generally* Constantino, Cannavo, and Goldstein, *Drug Courier Profiles and Airport Stops: Is the Sky the Limit?*, 3 W. NEW ENG. L. REV. 175 (1980) (discussing and criticizing use of drug courier profile); Greenberg, *Drug Courier Profiles*, Mendenhall *and* Reid: *Analyzing Police Intrusions On Less Than Probable Cause*, 19 AM. CRIM. L. REV. 49 (1981) (same); Comment, *Criminal Profiles After* United States v. Mendenhall: *How Well Founded A Suspicion?*, 1981 UTAH L. REV. 557 (same); Comment, Mendenhall *and* Reid: *The Drug Courier Profile and Investigative Stops*, 42 U. PITT. L. REV. 835 (1981) (same); Comment, United States v. Mendenhall: *DEA Airport Search and Seizure*, 16 NEW ENG. L. REV. 597 (1981) (same); Note, State v. Reid: *Airport Searches and the Drug Courier Profile in Georgia*, 33 MERCER L. REV. 433 (1981) (same).

118. Johnson v. United States, 333 U.S. 10, 14 (1948).

119. *See Reid*, 448 U.S. at 441 (characteristics in drug profile describe large category of innocent travelers).

120. *See supra* note 29 (citing cases holding that dog sniffs are not searches).

121. *See supra* text accompanying notes 32-48 (discussing expectation of privacy associated with luggage).

122. The exceptions to the warrant requirement are: 1) search incident to a valid arrest; 2) plain view; 3) exigent circumstances; 4) automobile searches; 5) inventory searches; 6) border searches; 7)

B. DOG-SNIFF SEARCHES SHOULD BE SUPPORTED BY PROBABLE CAUSE

A warrantless search, such as that considered in *Beale*, is per se unreasonable under the fourth amendment "subject only to a few specifically established and well-delineated exceptions."[123] The exceptions excuse the failure to obtain a warrant from a neutral magistrate, but do not serve as substitutes for probable cause.[124]

In two limited circumstances the Supreme Court has allowed less than probable cause to justify a warrantless search.[125] The Supreme Court first deviated from the probable cause requirement in *Terry v. Ohio*.[126] In *Terry*, a police officer observed several men acting nervously and suspected them of preparing for a robbery.[127] The officer approached the men and asked their names.[128] When they refused to answer, the officer patted down their outer clothing and found a gun.[129] The defendant challenged the initial "stop and frisk" as a violation of the fourth amendment's prohibition against unreasonable searches and seizures. The Supreme Court balanced the need to protect police officers from armed suspects with the individual's right to privacy and concluded that police officers have a "narrowly drawn authority" to conduct a limited pat-down search when they have a reasonable suspicion that the suspect is

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consent; 8) investigative detentions; and 9) administrative searches of pervasively regulated businesses. *See* Project, *Twelfth Annual Review of Criminal Procedure: United States Supreme Court and Courts of Appeals 1981-82*, 71 GEO. L.J. 253, 369-96 (1982) (general discussion of permissible warrantless searches). The police normally must have probable cause to conduct a warrantless search. *See, e.g.*, United States v. Ross, 102 S. Ct. 2157, 2164 (1982) (automobile exception requires that police have probable cause to search automobile); United States v. Robinson, 414 U.S. 218, 235 (1973) (arrest based upon probable cause justifies search incident to arrest). In two limited situations the fourth amendment does not require the police to have probable cause to conduct a search. *See* United States v. Brignoni-Ponce, 422 U.S. 873, 881 (1975) (reasonable suspicion justifies stop near border); Terry v. Ohio, 392 U.S. 1, 21 (1968) (reasonable suspicion that suspect is armed and dangerous justifies stop and frisk).

123. *Katz*, 389 U.S. at 357 (footnote omitted).

124. *See supra* note 122 (citing cases establishing probable cause requirement and exceptions).

125. *See infra* notes 126-35 and accompanying text (discussing exceptions to probable cause requirement). The Supreme Court also has held that the fourth amendment does not require police to have probable cause to conduct a routine checkpoint operation. United States v. Martinez-Fuerte, 428 U.S. 543, 562 (1976). The intrusive nature of the seizure and the threat of arbitrary exercise of police power are minimized because the police stop all oncoming traffic. *See id.* at 557-59 (routine stop does not result in discretionary law enforcement and generates little concern among motorists). The roadblock doctrine lends no support to the abandonment of the probable cause standard in dog-sniff cases. Dogs are not called upon to sniff all luggage for contraband. Rather, dogs are used following a subjective exercise of police discretion.

Administrative inspections of air travelers and their luggage are often made in the absence of a warrant or probable cause. *See* 3 W. LAFAVE, *supra* note 76, at 327-64 (discussing rationale for airport administrative searches). The rationale for allowing such inspections, however, does not support the adoption of a reasonable suspicion standard for sniff searches. All airline passengers are subjected to administrative searches, and the searches promote the overriding public interest of protecting the immediate safety of airline travelers from the threat of hijackers. Neither of those justifications is present in dog-sniff cases.

In addition, a search must involve some form of government action in order for there to be a violation of the fourth amendment. Burdeau v. McDowell, 256 U.S. 465, 473-75 (1921). Airport administrative searches that do not involve government agents, therfore, are not invalid. United States v. Jennings 653 F.2d 107, 110 (4th Cir. 1981) (fourth amendment inapplicable when private employee of airline searched package for drugs).

126. 392 U.S. 1 (1968).

127. *Id.* at 5-6.

128. *Id.* at 6-7.

129. *Id.* at 7.

armed.[130] The Court emphasized that it was the potential danger to the officer that justified the limited pat-down of the suspect's clothing for weapons.[131] In addition, even when an officer believes that he is in danger, he must act in response to specific reasonable inferences drawn from facts, not in response to an "inchoate and unparticularized suspicion or 'hunch.' "[132]

Warrantless searches occuring at the border constitute the second category of exceptions to the probable cause requirement. In *United States v. Brignoni-Ponce*,[133] the Supreme Court authorized border patrol officers to stop a vehicle near the border based on reasonable suspicion that the vehicle contained illegal aliens.[134] The government interest in stopping the flow of large numbers of illegal aliens into the country and the lack of alternatives for policing the border justified the abandonment of the probable cause standard.[135]

Some commentators argue that *Terry* provides Supreme Court precedent to support the use of a reasonable suspicion standard in sniff-search cases.[136] An examination of the Court's rationales in those two cases, however, demonstrates that neither supports such a result.[137] In *Terry*, the overriding government interest in protecting the safety of police officers justified the limited pat-down for weapons.[138] The Court did not rest its decision on the need to prevent the commission of the suspected crime. In contrast, the government in *Beale* lacked an interest in ensuring the safety of the officer. The only governmental interest in *Beale* was preventing the commission of a suspected crime. *Terry*, therefore, is inapposite.

Similarly, the special exigencies that necessitate border stops are absent in dog-sniff cases. In *Brignoni-Ponce* the Supreme Court emphasized the public interest in preventing the influx of large numbers of illegal aliens because of the threat of economic and social disruption.[139] The public interest implicated in *Beale*, halting the flow of narcotics, might be as socially important as the interest in halting the flow of illegal aliens into the United States. The expectations of privacy involved in *Beale* and *Brignoni-Ponce*, however, are quite different. The Court in *Brignoni-Ponce* upheld a brief stop of a vehicle

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130. *Id.* at 27.

131. *Id.* The Court stressed that the "long tradition of armed violence" among American criminals poses a threat to the safety of law enforcement officers. *Id.* at 23-24.

132. *Id.* at 27.

133. 422 U.S. 873 (1975).

134. *Id.* at 881.

135. *Id.* at 878-79. The Supreme Court also condones searches, without a warrant, and without a showing of probable cause, of items entering this country through customs. *See* United States v. Ramsey, 431 U.S. 606, 619 (1977) (customs search reasonable merely because item or person has entered country from outside). *See also* 3 W. LAFAVE, *supra* note 98, at 276-78 (history of warrantless customs searches without probable cause justifies practice).

136. *See Sense-Enhancing Devices*, *supra* note 82, at 1199 (*Terry* limited search concept can justify dog sniffs); Peebles, *The Uninvited Canine Nose and the Right to Privacy: Some Thoughts on* Katz *and Dogs*, 11 GA. L. REV. 75, 95 (1976) (*Terry* analysis appropriate for dog-sniff cases because dog sniff not full search); *Search and Seizure*, *supra* note 48 at 337 (*Terry* balancing approach consistent with society's needs and individual rights).

137. Interestingly, the *Beale* court did not justify its reasonable suspicion standard by invoking *Terry*. The court relied on *Terry* only twice in its discussion of dog sniffs, citing Justice Douglas' dissent in both instances.

138. *See supra* notes 130-31 and accompanying text (discussing *Terry* rationale).

139. 422 U.S. at 878-79.

reasonably suspected of containing illegal aliens.[140] Those travelling in an open vehicle on a public highway along an international border have a limited expectation of privacy.[141] Conversely, travelers have a high expectation of privacy in the contents of their luggage.[142] The rationale of *Brignoni-Ponce*, therefore, does not support the result reached in *Beale*.

Although the Ninth Circuit purported to make a significant break from the prevailing judicial view by recognizing that a dog sniff constitutes a search, in practice the court's articulable suspicion standard does not lead to a result different from that of prior decisions holding that dog sniffs are not fourth amendment searches.[143] The court's rule provides little more protection than the rule of *Bronstein*.[144] Under either test, the practice of using dogs to sniff luggage is allowed without a finding of probable cause.[145] Courts that have followed the *Bronstein* approach to dog-sniff cases could have reached the same result on the alternative theory that articulable suspicion existed to believe that the suspect was transporting narcotics.[146] Because those courts held

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140. *See id.* at 881-82 (officers with reasonable suspicion may stop vehicle momentarily and ask questions to occupants, but may not search vehicle or occupants). The Supreme Court still requires that vehicle searches near the border be based on probable cause. *See* Almeida-Sanchez v. United States, 413 U.S. 266, 273 (1973) (absent warrant or probable cause, search of automobile near border violates fourth amendment).

141. *Brignoni-Ponce*, 422 U.S. at 883 n.8 (decision to allow brief detention without probable cause considers importance of policing border). *See also* Torres v. Puerto Rico, 442 U.S. 465, 472-73 (1973) (government has "inherent sovereign authority to protect its territorial integrity").

142. *See supra* notes 32-48 and accompanying text (discussing expectation of privacy associated with luggage).

143. *Compare Beale*, 674 F.2d at 1335 (sniff search may be allowed using reasonable suspicion standard) *with Waltzer*, 682 F.2d at 372 (dog sniff allowed because not a search). *See also* Note, *Sense-Enhancing Devices*, *supra* note 82, at 1201 (little practical difference between holding dog sniff not a search and holding it a search justified under *Terry*).

144. *Bronstein*, 521 F.2d 459, 461-62 (dog sniff not a search).

145. The only difference between the two tests is that *Beale* requires the additional finding of reasonable suspicion.

146. For some examples of cases in which the court found or could have found that a search was supported by reasonable suspicion that the defendant was a drug courier, *see* United States v. Waltzer, 682 F.2d 370, 372 (2d Cir. 1982) (suspect's luggage sniff searched after agent observed nervousness, fidgeting, and shaking consistent with drug courier profile; court did not reach issue whether behavior consistent with drug courier profile justifies stop); United States v. Goldstein, 635 F.2d 356, 372 (5th Cir.) (suspects' luggage sniff searched after agent observed suspects casting side glances toward each other but not speaking, and exhibiting other characteristics consistent with drug courier profile; court noted that mere manifestation of certain drug courier profile characteristics does not constitute reasonable suspicion), *cert. denied*, 452 U.S. 962 (1981); United States v. Klein, 626 F.2d 22, 24 (7th Cir. 1980) (suspects' luggage detained for sniff search after officers observed numerous characteristics consistent with drug courier profile; court noted detaining luggage a logical extension of *Terry*); United States v. Sullivan, 625 F.2d 9, 10 (4th Cir. 1980) (suspects' luggage sniff searched after agents observed behavior consistent with drug courier profile), *cert. denied*, 450 U.S. 923 (1981); and United States v. Bronstein, 521 F.2d 459, 465 (2d Cir. 1975) (Mansfield, J., concurring) (reasonable suspicion to sniff search luggage exists when agents receive reliable information that suspects have exhibited behavior consistent with drug courier profile), *cert. denied*, 424 U.S. 918 (1976).

These cases all involved drug courier profiles. It should be noted that the Supreme Court has not decided whether reasonable suspicion may be based on matching a suspect's behavior with a drug courier profile. *But cf.* United States v. Mendenhall, 446 U.S. 544, 560 (1980) (Powell, J., concurring) (reasonable suspicion may be based on matching a suspect's behavior with drug courier profile); Reid v. Georgia, 448 U.S. 438, 440-41 (1980) (per curiam) (reasonable suspicion not present when suspect exhibited only following four characteristics from drug courier profile: defendant arrived from source city; defendant arrived early in morning; defendant and companion appeared to attempt to conceal traveling together; defendant and companion had no luggage other than shoulder bags). *See generally supra* note 111 (discussing drug courier profiles).

that the use of dogs to sniff luggage is not a search, however, the existence of reasonable suspicion was not an issue. As the *Beale* court noted, its articulable suspicion standard is "consistent with the unarticulated reasoning" of several prior cases.[147]

C. DOG-SNIFF SEARCHES WILL NOT ALWAYS REQUIRE A WARRANT

Despite Supreme Court precedent firmly establishing the rule that warrantless searches are per se unreasonable, it still may be possible under some circumstances to conduct sniff searches of luggage without a search warrant.[148] Before conducting a search, the police would have to establish probable cause as required by the exceptions to the warrant requirement.[149] To do so, the police could rely on tips.[150] Additionally, police might be able to utilize the drug courier profile, refined by greater reliance on an agent's actual knowledge of a suspect's drug-trafficking activities and other corroborative information. Once the police have established probable cause, it may be possible to invoke one or more of the exceptions to the warrant requirement.

The three exceptions to the warrant requirement applicable to sniff searches are the consent exception, the search incident to a valid arrest exception, and the exigent circumstances exception.[151] Obviously, if a person consents to a sniff search the fourth amendment does not require the police to obtain a warrant.[152] Under the search incident to a valid arrest exception, the police may search a suspect and the area within his immediate control following a valid arrest.[153] Thus, if an arrest is made while the suspect is in possession of his luggage, the search incident to a valid arrest exception would permit a dog sniff. The Supreme Court qualified the exception in *United States v. Chadwick*[154] by ruling that the search of a container is no longer incident to a valid arrest once it is in the exclusive control of the police.[155] Despite that qualification, it may still be possible to justify the use of dogs to sniff luggage as a

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147. *Beale*, 674 F.2d at 1335, citing United States v. Klein, 626 F.2d 22, 25 (7th Cir. 1980) (suspicious conduct and agents' observations provided reasonable suspicion that suitcases contained contraband); United States v. Solis, 536 F.2d 880, 882 (9th Cir. 1976) (agents had "founded suspicion" that semi-trailer contained contraband); United States v. Bronstein, 521 F.2d 459, 461 (2d Cir. 1975) (police had ample cause to pursue lead and place suspects under surveillance), *cert. denied*, 424 U.S. 918 (1976).

148. *See supra* note 122 and accompanying text (discussing warrant requirement and exceptions).

149. *See supra* notes 123-42 and accompanying text (arguing that sniff searches must be supported by probable cause).

150. For cases involving the use of dogs to sniff luggage following a tip, see United States v. Burns, 624 F.2d 95, 98 (10th Cir.) (investigation leading to dog sniff commenced in response to informant's tip), *cert. denied sub. nom* Reynolds v. United States, 449 U.S. 954 (1980); United States v. Fulero, 498 F.2d 748, 748 (D.C. Cir. 1974) (same); State v. Elkins, 47 Ohio App. 2d 307, 307, 354 N.E.2d 716, 716 (1976) (same); People v. Furman, 30 Cal. App. 3d 454, 455, 106 Cal. Rptr. 366, 367 (1973) (same).

In general, a tip may establish probable cause if the officer possesses: 1) some of the underlying circumstances from which the informant concluded that a crime has been or is being committed and 2) some of the underlying circumstances from which the officer may conclude that the informant is credible or his information reliable. Aguilar v. Texas, 378 U.S. 108, 114 (1964).

151. *See supra* note 122 (listing exceptions to warrant requirement).

152. Schneckloth v. Bustamonte, 412 U.S. 218, 219 (1973).

153. Chimel v. California, 395 U.S. 752, 762-63 (1969).

154. 433 U.S. 1 (1977).

155. *See id.* at 15 (1977) (exclusive control of footlocker by police eliminates danger that arrestee might seize weapon or destroy evidence and thereby undercuts rationale for exception). *See also* 2 W. LAFAVE, *supra* note 76, at 353-54 (expressing uncertainty about impact of *Chadwick* on searches of containers incident to arrest).

search incident to a valid arrest. In *Chadwick*, the Supreme Court required agents to seize a footlocker rather than conduct a warrantless search because the Court viewed the seizure as the lesser intrusion of the owner's privacy interests.[156] When considering the spectrum of fourth amendment intrusions, a dog sniff is less intrusive than opening and fully searching luggage because the sniff search only discloses the presence of contraband. Arguably, a dog sniff is a less serious intrusion than a seizure of luggage, which denies the owner access to his belongings. Thus, it might be more reasonable under *Chadwick* for the agents to conduct a warrantless sniff search incident to a valid arrest rather than seize the suspect's luggage.[157]

Under the exigent circumstances exception to the warrant requirement, after establishing probable cause the police may conduct a warrantless search to prevent the destruction of evidence.[158] The police might use this exception to justify a sniff search when the suspect does not have his luggage within his control. In *Chadwick*, however, the Supreme Court stated that there was no danger of destruction of evidence once the police had exclusive control of the container to be searched.[159] Again considering the spectrum of fourth amendment intrusions, however, a sniff search may present a less serious intrusion than the seizure of luggage.[160] A warrantless sniff search of luggage also might be justified under the exigent circumstances exception by facilitating the "apprehension of confederates."[161] It would be impractical to require police to seize luggage when to do so would alert the suspect's confederates.[162]

Thus it may sometimes be possible to justify warrantless sniff searches of air travelers' luggage under one of the above exceptions to the warrant requirement once the police have established probable cause. In other cases, however, it will be necessary to obtain a search warrant prior to using trained dogs.

D. PROBABLE CAUSE PROVIDES A CLEARER STANDARD THAN ARTICULABLE SUSPICION

The courts have not been receptive to the imposition of a probable cause standard in cases involving the use of dogs to sniff search luggage for contraband.[163] Undoubtedly the reluctance stems from the unwillingness of courts to restrict the use of such an effective investigative tool. Adherence to a reasonable suspicion standard in these cases, however, represents an unacceptable diminution of fourth amendment protections.

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156. *See Chadwick*, 433 U.S. at 13 (warrantless search of footlocker greater intrusion than seizure; unreasonable to undertake greater intrusion when footlocker safely immobilized).

157. *But see supra* text accompanying note 104 (arguing that more particularized nature of dog sniff does not distinguish it from other fourth amendment searches requiring probable cause).

158. Schmerber v. California, 384 U.S. 757, 770-71 (1966).

159. 433 U.S. at 15. *See also* 2 W. LAFAVE, *supra* note 76, at 353-54 (*Chadwick* appears to reject argument that exigency still exists once police have exclusive control over container).

160. *See supra* notes 156-57 and accompanying text (discussing intrusiveness of sniff search compared to seizure).

161. *Chadwick*, 433 U.S. at 21 (Blackmun, J., dissenting).

162. *See* 2 W. LAFAVE, *supra* note 76, at 368.

163. The author has found only one judge who believes that a probable cause standard is applicable in dog-sniff cases. *See* United States v. Thomas, 1 M.J. 397, 405 (C.M.A. 1976) (Ferguson, J., concurring) (use of dog without probable cause to sniff locker for drugs unreasonable under fourth amendment).

The *Beale* decision, despite the court's intention,[164] further contributes to what Professor Amsterdam terms a "sliding scale" approach to fourth amendment jurisprudence, unnecessarily complicating and confusing the existing doctrines.[165] A sliding scale approach provides graduated fourth amendment protections varying with the intrusiveness of the search and the justification for the intrusion.[166] Although a sliding scale may make decisions easier for the courts by allowing them to decide each case on its facts, the use of such an approach would result in a diminution of fourth amendment protections because courts are likely to defer to police officers' judgment.[167] The cases will provide no clear rules, thereby transforming the fourth amendment "into one immense Rorschach blot."[168] *Beale* represents a step toward such a transformation.

Beale affords little fourth amendment protection to dog-sniff cases because of a subjective determination that an airline traveler's luggage does not merit full fourth amendment protection. Such subjective determinations concerning expectations of privacy in various settings fail to provide adequate standards to guide police conduct[169] and, therefore, facilitate the evisceration of fourth amendment protections. The treatment of containers in *United States v. Ross*[170] illustrates this point.[171] As Professor Amsterdam points out, the Supreme Court has struggled to create a reasonably coherent fourth amendment rubric.[172] The fourth amendment's probable cause requirement provides a readily-identifiable and understandable standard of conduct in dog-sniff cases and also preserves valued privacy interests.

CONCLUSION

It is crucial for courts to hold that the use of dog sniffs to detect contraband in luggage is a search. Otherwise, there can be no fourth amendment limita-

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164. *See Beale*, 674 F.2d at 1335-36 n.20 (court does not intend any dilution of fourth amendment rights).

165. *See* Amsterdam, *Perspectives on the Fourth Amendment*, 58 MINN. L. REV. 349, 392-94 (1974) (balancing approach to fourth amendment leads to sliding scale and potential diminution of fourth amendment protections). The *Beale* court took cognizance of Professor Amsterdam's view, but noted that the court's holding extended only to pervasively regulated situations in which the individual's expectation of privacy is relatively small. *Beale*, 674 F.2d at 1335-36 n.20.

166. Amsterdam, *supra* note 165, at 390.

167. *Id.* at 394.

168. *Id.* at 393.

169. *Compare* United States v. Goldstein, 635 F.2d 356 (5th Cir.) (sniff search of baggage left unattended in baggage area permissible without articulable suspicion), *cert. denied*, 452 U.S. 962 (1980) *with* United States v. Carson, 46 C.M.R. 203 (C.M.A. 1973) (sniff search of luggage improper when owner maintained control of bag).

170. 102 S.Ct. 2157 (1982).

171. In *Ross*, a three judge panel of the United States Court of Appeals for the District of Columbia concluded that the constitutionality of a warrantless search of containers found within an automobile depends on the owner's expectation of privacy in the container's contents. *Id.* at 2160. Applying that test, the court held that the search of a paper bag was justified but the search of a leather pouch was not. *Id.* at 2160-61. The entire Court of Appeals rejected the panel's conclusion, finding that no distinction of constitutional significance existed between the paper bag and the leather pouch. *Id.* at 2161. The Supreme Court affirmed the finding of the circuit court. *Id.* at 2171.

172. *See* Amsterdam, *supra* note 165, at 395 (Court has struggled to mold existing fourth amendment jurisprudence).

tions on the practice.[173] The Ninth Circuit has overcome this hurdle by recognizing, consistent with Supreme Court precedent, that luggage is inherently associated with a reasonable expectation of privacy. That expectation is intruded upon when a dog indicates the contents of luggage to the authorities.

Beale's articulable suspicion standard, however, provides little fourth amendment protection for an individual's privacy interest and approves greater reliance on subjective aspects of police investigation. Moreover, the Ninth Circuit's use of a reasonable suspicion standard is not supported by Supreme Court precedent. The *Beale* court should have required that probable cause precede the use of dog sniffs in order to adequately protect important privacy interests. The use of an articulable suspicion standard to uphold a trained dog-sniff search of luggage improperly extends authority to the police beyond the strictures of the fourth amendment's prohibition of unreasonable searches and seizures.

William F. Timmons

173. *See Constitutional Limitations*, *supra* note 64, at 973.

Civilian Speech on Military Bases: Judicial Deference to Military Authority

Persons for Free Speech at SAC v. United States Air Force, 675 F.2d 1010 (8th Cir.) (en banc), *cert. denied*, 103 S. Ct. 579 (1982)

Each year, Offutt Air Force Base (OAFB)[1] invites the public onto designated areas of the base during an open house.[2] Because OAFB is a closed base, civilians ordinarily may not enter without advance permission from the base commander. The Air Force encourages the public to attend the open house, however, to promote community relations and to present a favorable environment for recruitment.[3] As many as 250,000 civilians have attended the annual event, which generally features demonstrations of military equipment, entertainment by military groups, and recruiting and information booths.[4] Selected nonmilitary groups, including defense contractors, local civic groups, and safety organizations, are also allowed to distribute information promoting their activities from booths.[5]

In 1981 a group called Persons for Free Speech at SAC (PFS) requested permission to participate in the open house.[6] In a letter to the base commander, the group stated that it sought to "present an alternative to the extremely dangerous and costly arms race"[7] by distributing literature and presenting theatrical demonstrations.[8] The base commander denied the request on the ground that PFS' participation would be inconsistent with the purpose of the open house.[9]

Although PFS was eventually denied injunctive relief and the opportunity to participate in the open house,[10] the United States Court of Appeals for the Eighth Circuit remanded the case to the district court because resolution of the issues would affect participation in future open houses.[11] The Eighth Circuit directed the district court to address whether OAFB had waived its right to

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1. OAFB is the headquarters for the Strategic Air Command (SAC). Persons for Free Speech at SAC v. United States Air Force, 675 F.2d 1010, 1012 (8th Cir.) (en banc), *cert. denied*, 103 S. Ct. 579 (1982).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.* PFS' amended complaint added that it sought "to speak to the propriety of nuclear proliferation, bilateral disarmament, the conversion of the weapons of war to instruments of peace, and the very existence of OAFB in our community." *Id.*
8. *Id.* PFS' plans for participation included a slide show, clowns, theater, songs, leafletting, and distribution of peace literature. *Id.* PFS stated it would be willing to comply with applicable time, place, and manner restrictions placed on participants. *Id.*
9. *Id.*
10. *Id.* PFS requested to participate in the June 14, 1981, open house by letter dated May 21, 1981. *Id.* The base commander denied PFS' request by letter dated May 29, 1981. *Id.* PFS' request for declaratory and injunctive relief in federal district court on June 11 was denied after a hearing on June 12. *Id.* A three-judge panel of the Eighth Circuit heard an expedited appeal on June 13 and denied relief because of the time element and limited record. *Id.* PFS' petition to the United States Supreme Court for a preliminary injunction was denied by Justice Blackmun on the evening of June 13. *Id.* at 1013.
11. *Id.*

ban speech at the open house, whether OAFB had discriminated against PFS by allowing other nonmilitary organizations to participate in the open house, and whether the base commander could ban PFS' participation without finding that it would disrupt the discipline and morale of the troops.[12] On remand, the district court upheld the exclusion,[13] and the decision was affirmed by the Eighth Circuit in *Persons for Free Speech at SAC v. United States Air Force*.[14]

This comment strongly disputes the holding and the reasoning of the Eighth Circuit in *Persons*. After discussing the majority and dissenting opinions in *Persons*, the comment presents three alternative arguments to illustrate that PFS should have been permitted to participate in the open house. First, the comment argues that the proper application of an existing Air Force regulation prohibiting the selective benefit of any commercial or ideological group should have resulted either in admitting PFS or excluding all nonmilitary commercial and ideological groups. The comment then illustrates that the open house created a forum open to the public for the free communication of ideas. Finally, the comment contends that even if PFS did not have a guaranteed right of access to the base, once OAFB opened the base to some nonmilitary groups, PFS had an equal right of access to the forum and could not be excluded solely on the basis of the viewpoint it presented.

I. THE REASONING OF THE EIGHTH CIRCUIT

A. THE MAJORITY OPINION

The majority in *Persons* first considered whether the open house on the army base had created a temporary public forum, thus extending to civilians the right to use the unrestricted areas for free expression.[15] PFS argued that OAFB engaged in speech by inviting the public onto the base and conveying a specific message.[16] PFS contended that by using the open house to convey its "message" to the public, the Air Force had opened a normally nonpublic

12. *Id.*

13. The district court's findings of fact outlined four types of groups that had been permitted to participate in the open house. *Id.* These groups included organizations providing support services to those attending the open house, groups playing an integral role in the functioning of the military, community organizations in which OAFB personnel were involved, and safety organizations. *Id.*

The lower court's conclusions of law first rejected the claim that the open house turned the base into a forum open to the public for free expression on the day of the open house. *Id.* at 1014. *See infra* notes 81-109 and accompanying text (discussing public forum concept). The district court then reviewed an Air Force regulation prohibiting the Air Force from selectively benefitting or appearing to benefit or favor any commercial or ideological group. 675 F.2d at 1014. *See infra* notes 60-76 and accompanying text (discussing regulation). The trial court upheld the regulation on its face as a permissible subject matter regulation and also ruled that the regulation had been objectively and even-handedly applied. 675 F.2d at 1014. Finally, the lower court concluded that the base commander need only provide a rational basis for excluding PFS. *Id.* The court found it reasonable to exclude PFS based on the notion that the military is to be kept free of entanglement with political and ideological concerns. *Id.*

14. *Id.* at 1022-23. The Eighth Circuit, sitting en banc, affirmed the district court's decision in a five to three vote. *Id.* at 1012, 1023.

15. *Id.* at 1015. A standard definition of what constitutes a public forum has yet to be developed and is, in fact, the central first amendment issue addressed in *Persons*. The lack of clarity in the *Persons* public forum analysis is troubling because of the implications that a public forum classification has on the degree of protection granted to expression. *See infra* notes 81-109 and accompanying text (discussing public forum concept).

16. *Persons*, 675 F.2d at 1015.

forum by abandoning its primary defense mission and its claimed ideological neutrality.[17] The Eighth Circuit, reasoning that public forum determinations rest on considerations of the historical and traditional uses of government property, framed the issue as whether the open house was such a deviation from the historical and traditional uses of OAFB that it had created a public forum.[18]

The *Persons* court held that the open house had not created a public forum, rejecting several of PFS' arguments that the use of the base for the open house indicated that OAFB had abandoned temporarily the traditional uses of the base and the neutrality of the Air Force. The Eighth Circuit first concluded that OAFB had not abandoned its traditional control over base property solely because a large number of people entered the base on the day of the open house.[19] The *Persons* court cited *Greer v. Spock*,[20] in which the Supreme Court held that political candidates do not have a generalized constitutional right to enter a military base for campaign purposes,[21] to support its conclusion that the government does not abandon control over an area whenever it permits the public free access to the property.[22]

The *Persons* majority next rejected PFS' argument that OAFB had abandoned its traditional national defense mission by speaking to promote community relations.[23] The majority reasoned that although the primary mission of the military is national defense, the promotion of good community relations through the open house supported this mission and did not therefore indicate an abandonment of the traditional purposes of the base.[24]

PFS also unsuccessfully argued that OAFB had abandoned the traditional ideological neutrality of the military by conveying an ideological message during the open house.[25] Although the majority conceded that military demonstrations convey an ideological message, the court argued that the display of current weapons systems did not express the military's ideological viewpoint but merely reflected the national defense mission mandated by civilian lead-

17. *Id.*
18. *Id.*
19. *Id.*
20. 424 U.S. 828 (1976).
21. *Id.* at 838. In *Greer*, several political candidates claimed that regulations at the Fort Dix Army post banning political campaign speeches and requiring the commander's prior approval of all literature distributed on the post violated their first and fifth amendment rights. *Id.* at 832-34. The Supreme Court held that political candidates did not have a generalized right to enter the post for purposes of political campaigning because the military post, although open to civilian traffic, was not "historically and constitutionally" a place of free speech and assembly for civilians. *Id.* at 838. Rather, the Court argued that "[o]ne of the very purposes for which the Constitution was ordained and established was to 'provide for the common defense' . . . . Consequently [it is] the business of a military installation like Fort Dix to train soldiers, not to provide a public forum." *Id.* at 837-38. The Court also held that the regulations had been objectively and even-handedly applied. *Id.* at 838-39. Although other speakers had been allowed to enter the base on prior occasions, all speeches of a partisan political nature had been strictly prohibited. *Id.* at 831. The Court emphasized that the regulations served the "American constitutional tradition of a politically neutral military establishment under civilian control." *Id.* at 839.
22. 675 F.2d at 1015. The court reasoned that the detailed operations and security plans for the open house were inconsistent with the idea of abandonment of control over the base. *Id.* at 1015-16.
23. *Id.* at 1016.
24. *Id.*
25. *Id.* at 1017.

ers.[26] Moreover, the *Persons* court argued that even if the military had engaged in "governmental speech," the military had not abandoned its traditional ideological neutrality because the open house served a legitimate government interest by showing citizens how their money is spent.[27] The Eighth Circuit bolstered its view that government speech alone did not transform the base into a public forum by citing Supreme Court dictum which indicates that a place does not become a public forum solely because it is used for the communication of ideas.[28]

After rejecting PFS' public forum arguments, the court addressed the claim that the Air Force discriminated against PFS when it allowed some civilian

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26. *Id.* The *Persons* court cited Parker v. Levy, 417 U.S. 733 (1974), to support its proposition that civilians make the ideological decisions of the military. 675 F.2d at 1017. *Parker* upheld an Army physician's conviction under military regulations proscribing willful disobedience to a superior and conduct unbecoming a gentleman. 417 U.S. at 760-61. The *Parker* Court noted that the military criminal code regulates a far broader range of conduct than a civilian criminal code, but often imposes less harsh sanctions for minor breaches of the rules. *Id.* at 750-51. The Court attributed the lesser sanctions to the unique relationship between the civilian government, as employer, and the members of the military community, as employees. *Id.* at 751. The *Parker* Court also pointed out that the military establishment is subject to control by civilian leaders, such as the President and the department heads under him, and is to carry out the policies of those civilian superiors. *Id.*

The principle of civilian control of the military is both constitutionally and historically based. The Constitution provides for a civilian-controlled military by placing the war power in Congress, U. S. CONST. art. I, § 8, cl. 11, limiting Army appropriations to two years, *id.* art. I, § 8, cl. 12, and requiring the President to act as Commander in Chief of the Armed Forces, *id.* art. II, § 2, cl. 1. The constitutional principle stemmed from the historically perceived dangers to civilian society of an independent and powerful military. *See* Yarmolinsky, *Civilian Control: New Perspectives for New Problems*, 49 IND. L.J. 654, 655 (1974) (discussing historical and constitutional basis for civilian control of military); Zillman & Imwinkelried, *The Legacy of* Greer v. Spock: *The Public Forum Doctrine and the Principle of the Military's Political Neutrality*, 65 GEO. L. J. 773, 793-94 (1977) (discussing historical basis of American principle of civilian supremacy over military).

The *Persons* Court argued that the military is ideologically neutral because it is subject to civilian control. 675 F.2d at 1017. *See also* Greer v. Spock, 424 U.S. 828, 839 (1976) (military base policy of excluding all partisan political campaign matters held consistent with constitutional tradition of politically neutral military under civilian control). Some commentators argue, however, that civilian control of the military is not synonymous with ideological neutrality. *See* Zillman & Imwinkelried, *supra*, at 791. Another writer argues that the military is not ideologically neutral because it speaks through its leaders who, although civilians, are also members of the government. *See* Shiffrin, *Government Speech*, 27 U.C.L.A. L. REV. 565, 565 n.* (1980) (defining government speech to include all government supported speech regardless of government endorsement of views).

27. 675 F.2d at 1017. The majority apparently endorsed the definition of government speech adopted by Professor Shiffrin in a recent article. *See* Shiffrin, *supra* note 26, at 565 n.*. According to Professor Shiffrin, the term government speech includes all forms of state supported speech regardless of whether or not the speech is actually or perceived to be endorsed by the state. *Id. See infra* notes 138-42 and accompanying text (analyzing majority's government speech argument).

28. *Persons*, 675 F.2d at 1017. The *Persons* court cited United States Postal Serv. v. Council of Greenburgh Civic Ass'ns, 453 U.S. 114 (1981), which upheld the constitutionality of a postal regulation prohibiting the deposit of unstamped mail in letter boxes. *Id.* at 131. The *Greenburgh* Court reasoned that a mailbox is not automatically transformed into a public forum solely because it is designated the depository for mail. *Id.* at 128. The majority rejected Justice Brennan's argument that an instrumentality becomes a public forum when it is used for the communication of information and ideas. *Id.* at 130 n.6. The majority believed that acceptance of Justice Brennan's formulation would transform any public facility into a Hyde Park open to the whole public, regardless of the incompatibility of the use of the forum for free speech with its normal functions.

The *Greenburgh* Court found support for its opinion in Lehman v. City of Shaker Heights, 418 U.S. 298 (1974). In *Lehman* the Court held that because a bus is not a public forum, the city's managerial decision to limit advertising space on public buses to commercial ads did not violate the first amendment. *Id.* at 304. *See infra* notes 104-09 and accompanying text (discussing notion that use for communication does not tranform property into public forum).

groups to participate in the open house while denying participation to PFS.[29] The court began its analysis with the proposition that government regulation of speech in a nonpublic forum must be reasonable and content-neutral.[30] In determining the reasonableness of the base commander's actions, the *Persons* court argued that the commander's decision as to which groups should be allowed to participate in the open house should be accorded the same deference granted by the Supreme Court to discretionary decisions of prison administrators concerning which groups can operate in prisons.[31]

Employing this standard of review, the majority held that the commander's decision to exclude PFS while allowing other nonmilitary groups to participate in the open house was reasonable.[32] The majority, defining the purpose of the open house to be the fostering of good community relations, found it reasonable for the commander to admit only those groups that advanced that purpose.[33] The court noted that, unlike PFS, the civilian groups allowed to participate were either base-sanctioned (Explorer Scouts, Big Brothers/Sisters), community oriented (Chamber of Commerce), safety related, or involved in the daily activities of the base (defense contractors).[34] The majority also mentioned that the commander feared that participation by a group opposing the military would cause security problems.[35] The *Persons* court therefore held it was not an abuse of discretion to limit access to the open house to those groups whose subject matter the base commander deemed consistent with the purpose of the open house.[36]

Having upheld the base commander's action on the basis of its public forum

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29. *Persons*, 675 F.2d at 1018.

30. *Id.* (citing United States Postal Serv. v. Council of Greenburgh Civic Ass'ns, 453 U.S. 114, 131 n.7 (1981)). The *Persons* court adopted without explanation the reasonableness standard from the Supreme Court's mailbox decision in *Greenburgh*. *See supra* note 28 (discussing *Greenburgh*).

31. Jones v. North Carolina Prisoner's Labor Union, 433 U.S. 119, 136 (1977). *Jones* involved a challenge to prison regulations prohibiting prisoners from soliciting other inmates to join a prisoners' labor union and denying meeting and bulk mailing privileges. *Id.* at 121. Several prisoners challenged the application of the regulations because bulk mailing and meeting rights had been extended to several other groups, such as the Jaycees, Alcoholics Anonymous, and the Boy Scouts. *Id.* at 133. The *Jones* Court upheld the prison administrator's decision, reasoning that courts should defer to the views of prison administrators in recognition of the complexities and difficulties involved in the daily operation of a penal institution. *Id.* at 126. The *Persons* court's decision to defer to the military commander on the basis of its analogy to penal administration is challenged *infra* at notes 113-30 and accompanying text.

32. *Persons*, 675 F.2d at 1019.

33. *Id.*

34. *Id.*

35. *Id.* at 1020. *See infra* notes 124-29 and accompanying text (discussing legitimacy of security concern).

36. 675 F.2d at 1019-20. The court did not similarly defer to the base commander's decision to regulate "clothing messages" worn by individuals who attended the open house. *Id.* at 1020 n.9. The OAFB chief of security had ordered that civilians wearing buttons or other messages of a political or ideological nature be denied admittance to the base. *Id.* at 1014 n.3. The Eighth Circuit noted that the commander could not deny entrance to a member of PFS who was wearing a T-shirt that said "No Nukes in the Breadbasket." *Id.* To support this notion, the Eighth Circuit cited the Supreme Court's decision in Tinker v. Des Moines Indep. Community School Dist., 393 U.S. 503 (1969). *Tinker* held that the wearing of armbands by students to protest the Vietnam War was an act of symbolic expression and therefore could not be prohibited without a demonstration that the expression substantially interfered with the functioning of the school. 393 U.S. at 513-14. On the basis of *Tinker*, the Eighth Circuit indicated its belief that wearing the T-shirt was a symbolic expression which could not be abridged without a factual determination by the commander that the clothing message would substantially disrupt the open house. 675 F.2d at 1020 n.9.

and discriminatory access analysis, the *Persons* majority addressed PFS' argument that an Air Force regulation that prohibited the selective benefit of commercial and ideological groups was both unconstitutional on its face and as applied.[37] PFS argued that the regulation was unconstitutional on its face because, by engaging in ideological speech during the open house, the Air Force had given up its ideological neutrality and thus could not deny other ideological groups equal access to the base on that basis.[38] The majority, rejected the claim, however, distinguishing military speech that fosters community relations from military support of nonmilitary ideological movements.[39] The court argued that the principle of military nonentanglement requires noninvolvement by the military in civilian ideological movements in order to avoid undermining public confidence in civilian control of the military.[40]

The court also rejected PFS' contention that because the defense contractors were an ideological group and had not been barred from the open house, the regulation was discriminatorily applied to PFS.[41] In the court's view, the defense contractors' displays were not ideological because they only demonstrated, and did not debate, the current state of military weaponry.[42] Consequently, the court viewed the defense contractors' displays, similar to the military's own demonstrations, as merely demonstrative of the current state of the Air Force's equipment and not part of the debate over national defense policy.[43] The court therefore concluded the regulation was both constitutional as applied and on its face.[44]

B. THE DISSENT

Although agreeing that the open house fell within the traditional sphere of military activities and served legitimate military purposes,[45] the dissenters argued that the selective exclusion of PFS violated both the Air Force regulation and the first amendment.[46] The dissent first argued that the Air Force selectively benefited and endorsed the defense contractors in violation of the regulation by allowing defense contractors, as commercial and ideological ventures, to participate in the open house while denying PFS the same opportunity.[47] The dissent reasoned that the defense contractors had received a direct commercial benefit from their participation because the open house

37. 675 F.2d at 1021. *See infra* note 61 and accompanying text (quoting Air Force regulation).
38. *Persons*, 675 F.2d at 1021.
39. *Id.*
40. *Id.* at 1021-22.
41. *Id.* at 1022.
42. *Id.*
43. *Id.*
44. *Id.* The court briefly considered the denial of PFS' request, made after the booth denial, to distribute literature. *Id.* The court reasoned that because PFS' request for participation in the open house had included the distribution of literature, the denial of PFS' request for a booth was simultaneously a denial of its leafletting request. *Id.* The court implied that it was unneccessary for the Air Force to review the literature before disallowing its distribution. *Id.* The Air Force's policy of nonentanglement with ideological movements, as well as the lack of a generalized right to leaflet on a closed base, were found to be sufficient reasons to uphold the denial. *Id. See infra* note 59 (discussing dissent's view of distribution issue).
45. *Persons*, 675 F.2d at 1023 (Heaney, J., with Lay, C.J., and McMillan, J., dissenting).
46. *Id.*
47. *Id.* at 1023-24.

created a forum in which they were able to foster their image as competent producers of high technology products.[48] The dissent further maintained that by participating, the defense contractors endorsed their side of the ideological debate on national defense policy because demonstrations of their military products served to promote public support for the defense policies on which the continued production of weapons depends.[49] The dissent concluded that by permitting the presentation of one ideological perspective to the exclusion of PFS' views, the Air Force violated the first amendment.[50]

The dissent also accepted PFS' argument that the Air Force open house had created a temporary public forum.[51] The dissent argued that the magnitude of the open house, the large scale public involvement, and the participation by nonmilitary groups demonstrated the existence of a public forum from a commonsense perspective.[52] Moreover, the dissent believed that the legal requirements for a public forum had been met.[53] The dissent argued that the majority had mistakenly focused on the fact that the open house had become a traditional use of the military property,[54] and that the proper inquiry in the public forum analysis was whether PFS' proposed use of the base was incompatible with the activities of OAFB during the open house.[55] Because the open house audience was the public rather than soldiers undergoing basic training, as in *Greer*, the dissent concluded that under the *Greer* analysis, PFS' participation was compatible with the military's activities during the open house.[56]

Finally, the dissent rejected the majority's contention that because any ideological message conveyed at the open house was a civilian message, the military had not created a public forum.[57] According to the dissent, the message was government speech and had the same impact on the public whether it came from civilian leaders or the military.[58] The dissent concluded that if OAFB was to continue conducting the open house as it had in the past, it would have to permit PFS to participate in order to preserve the free expression guarantees protected by the first amendment.[59]

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48. *Id.* at 1024.
49. *Id.*
50. *Id.* at 1025.
51. *Id.*
52. *Id.* The dissent agreed with the majority that a public place does not become a public forum solely because the public is permitted to enter freely. *Id.* at 1025 n.5. Nonetheless, the dissent concluded that the surrounding facts and circumstances of the open house implied the existence of a public forum. *Id.*
53. *Id.* at 1026.
54. *Id.*
55. *Id.* *See infra* note 93 (discussing compatibility test).
56. *Id.* The dissent argued that as long as PFS' speech was regulated to the same extent as other participants' speech, it would not interfere with the civilian visitors to the open house, with the previously planned military displays and entertainment, or with the booths of other military and nonmilitary participants. *Id.* at n.6. The dissent also reasoned that PFS' ideological speech could not be considered incompatible with the open house solely because it expressed a viewpoint in opposition to the government's. *Id.* According to the dissent, to adopt the view that expression by PFS was incompatible with the purposes of the open house would imply that public property is never a public forum if the government does not agree with the ideas expressed. *Id.*
57. *Id.* at 1027.
58. *Id.*
59. *Id.* at 1029. The dissent also disagreed with the majority's conclusion that the Air Force properly denied PFS' request to distribute literature. *Id.* at 1028. The dissent urged that the "clear danger" standard of review, which allows the prohibition of literature distribution only when a clear danger to

II. CRITIQUE

The majority in *Persons* adopted an extremely restrictive view of freedom of speech and granted broad deference to the military base commander's decision to deny PFS' participation in the OAFB open house. With minimal analysis, the court dismissed three possible arguments, any one of which would have produced a result consistent with both the first amendment rights of PFS and the government's interest in maintaining a politically neutral, civilian-controlled military.

A. THE REGULATION

The most direct way to resolve the question of PFS' participation in the open house is to apply section 3(d) of Air Force Regulation 190-5,[60] which defines permissible Air Force participation with civilian groups at public events:

> Participation and cooperation must not directly or indirectly endorse or selectively benefit or favor or appear to endorse or selectively benefit or favor any private individual, group, corporation (whether for profit or nonprofit), sect, quasi-religious or ideological movement, fraternal organization, political organization, or commercial venture, or be associated with the solicitation of votes in a political election.[61]

The Air Force's decision to allow the defense industry and civic groups to participate in the open house, while denying access to PFS, violated both the regulation's proscription against selectively benefitting commercial or ideological groups and its proscription against indirectly or directly endorsing such groups.

First, the Air Force conferred an actual or apparent selective benefit on the contractors in violation of the regulation by allowing them to participate while

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military loyalty, discipline, or morale is found, should have been applied. *Id.* at 1028. *See* Brown v. Glines, 444 U.S. 348, 355 (1980) (regulation requiring members of Air Force to obtain approval of commander before circulating petitions upheld when regulation permitted commanders to oppose circulation only of materials posing clear danger to military loyalty, discipline, or morale); Greer v. Spock, 424 U.S. 828, 840 (1976) (army regulation prohibiting distribution of literature without prior approval of commander upheld because regulation authorized authorities to disapprove only of literature constituting clear danger to military loyalty, discipline, or morale).

The *Persons* dissent argued that the military had ignored the clear danger standard by excluding PFS even though the group had agreed to abide by reasonable time, place, and manner restrictions and by failing to examine the literature to determine if it would pose a danger to the military. 675 F.2d at 1028. Although the dissent suggested that the clear danger standard had been constitutionalized by the Court's decisions in *Greer* and *Brown*, it recognized that the regulations upheld in *Greer* and *Brown* had expressly included the clear danger language. *Id.* at 1028-29. Consequently, the dissent did not reach the issue of the constitutionality of the requirement because it believed that the violation of the regulation and the first amendment were adequate grounds upon which to declare the Air Force's action unconstitutional. *Id.* at 1029. The discussion of the literature issue is beyond the scope of this comment.

60. 32 C.F.R. § 824.4(d) (1982).

61. *Id.* Air Force Regulation 190-5 sanctions Air Force participation in public events to aid community relations, among other reasons. *Persons*, 675 F.2d at 1016. The regulation defines a community relations program as a program, including an installation open house, that "evaluates public attitudes, identifies the mission of a military organization with the public interest, and executes a program of action to earn public understanding and acceptance." *Id.* at 1016 (quoting Air Force Regulation 190-5(2)(j)).

excluding PFS. The defense contractors attending the open house[62] received a commercial benefit from their participation because, as the dissent noted, the contractors used the open house to foster their image as competent producers of high-technology products and to promote themselves to their military and civilian customers.[63] Similarly, the Air Force allowed the defense contractors to promote an ideological viewpoint during the open house, thus benefitting the contractors' side of the ideological debate over the nature of America's defense policies. The dissent argued persuasively that the defense contractors' display of products promoted public support for the defense policies essential to continued production of high-technology weapons systems.[64] Even though the contractors displayed only current technology, such products nevertheless represent the current ideological stance of the contractors and military toward national defense by indicating their support for the continued production of the products. Furthermore, even if the Air Force did not confer an *actual* benefit on the defense contractors, the contractors' displays at the open house created an *appearance* of the commercial and ideological benefits barred by the regulation.

The commercial and ideological benefits to the contractors, whether actual or apparent, were "selective" because PFS was denied permission to participate in the open house and thereby receive benefits as well. The Air Force could have complied with the regulation by extending the benefits to no one,[65] or by making the benefits available to all interested parties.[66] The base commander's decision to restrict any resulting benefits to particular groups, however, resulted in a selective benefit to such groups.

The Eighth Circuit's willingness to uphold OAFB's selective exclusion of one side of an ideological debate contrasts with the Supreme Court's decision in *Greer v. Spock*.[67] *Greer* involved a challenge to a military regulation that prohibited the presentation of all partisan political speeches on an Army base.[68] Although the constitutionality of the flat ban on political campaign activity was challenged, the actual application of the regulation in *Greer* was not at issue[69] because the regulation's prohibition had been "rigidly enforced," so that "no candidate of any political stripe had ever been permitted to campaign [at Fort Dix]."[70] The evenhanded application of the regulation in *Greer*

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62. The defense contractors included Boeing, General Electric, and McDonnell Douglas. *Persons*, 675 F.2d at 1024 (Heaney, J., with Lay, C.J., and McMillan, J., dissenting).

63. The dissent noted that private commercial contractors used the open house to engage in "institutional advertising" aimed at not only the military, but at everyday consumers of other products sold by the contractors. *Id.*

64. *Id.* at 1024-25.

65. The majority noted that if the military does not allow one side of a controversy on base, it need not allow the other side. *Id.* at 1022.

66. It is unclear from the opinion the extent to which groups other than the defense contractors that were allowed to participate received any commercial or ideological benefit from their participation in the open house. The Chamber of Commerce, for example, only handed out literature on the surrounding area and information on a local nature preserve. *Id.* at 1019. Nonetheless, the literature on the surrounding area may have included information on area commerce, thus conferring a commercial benefit on local businesses.

67. 424 U.S. 828 (1976).

68. *Id.* at 831.

69. *Id.* at 838.

70. *Id.* at 831, 839.

prohibited all partisan political expression from being directed at a military audience on the base. In contrast, the selective exclusion of PFS precluded a largely civilian audience from hearing one side of an ideological debate on the nation's defense policies.

Secondly, the base commander violated the regulation's prohibition against the direct or indirect endorsement of any ideological or commercial group by allowing the defense contractors and other nonmilitary groups to participate. Arguably, participation by any organization, including PFS, violates this clause of the statute, because the Air Force implicitly endorses groups by permitting them to participate. No endorsement of any particular group by the Air Force could be implied, however, if any applicant who had applied to participate and who had agreed to abide by the fair's restrictions was free to participate in the open house. Consequently, the Air Force could have complied with the regulation's nonendorsement clause by allowing all interested groups to participate. By limiting participation to selected applicants, however, the Air Force at least indirectly endorsed those groups which were allowed to participate.

The *Persons* majority never addressed the assertions, raised above, that the Air Force violated the regulation by selectively benefitting or endorsing, or appearing to selectively benefit or endorse certain commercial or ideological groups. Rather, the majority focused exclusively on the constitutionality of the base commander's application of the regulation's proscription against favoring civilian ideological groups. The majority's limited analysis of the regulation suggests that the mere participation by civilian ideological groups violates the regulation, whereas the participation by commercial interests does not. The language of the regulation, however, treats each of the proscribed categories equally, prohibiting the Air Force from endorsing, selectively benefitting, or favoring, or appearing to endorse, selectively benefit, or favor ideological groups or commercial ventures. Therefore, the majority's conclusion that the defense contractors were not ideological groups[71] does not resolve the regulation issue, as the contractors nonetheless have a commercial character. If ideological groups are barred under the regulation as a forbidden category, then commercial ventures, another forbidden category, should also be barred. Neither the Eighth Circuit's decision nor the regulation itself justifies disparate treatment of these two categories of forbidden participants.

It is interesting to note that the *Persons* majority analyzed the regulation only after it had first addressed the constitutional issues presented by PFS, and even then considered only the constitutionality of the regulation. In this respect, the Eighth Circuit's opinion appears to be patterned methodically on *Greer*, which began with a public forum analysis.[72] In *Greer*, however, only the constitutionality of the ban itself was under attack,[73] as the military's strict adherence to the regulation banning political speeches was not questioned.[74]

71. *Persons*, 675 F.2d at 1022.
72. *Greer*, 424 U.S. at 838-39.
73. *Id.* at 838.
74. While some nonpolitical civilian speakers had visited the base, the regulation applied only to political candidates. *Id.* at 838 & n.10. Respondents did not allege that discrimination between political candidates had occurred. *Id.* at 838.

Thus it was logical and perhaps unavoidable for the *Greer* Court to have begun with the public forum analysis.[75] Unlike the *Greer* Court, however, the *Persons* court had the option of resolving the controversy without ever embarking upon the constitutional public forum analysis by relying upon the violation of Section (3)(d) of AFR 190-5. The *Persons* court should have tried initially to resolve the controversy on the basis of the regulation, thereby avoiding the constitutional inquiry altogether.[76] Because the *Persons* court did address the constitutional issues, however, the next part of the comment focuses on the serious first amendment and equal protection issues raised by the majority's decision.

B. CONSTITUTIONAL ANALYSIS

The exclusion of PFS from the base on the day of the open house presents two constitutional issues concerning the use of a public place for the expression of ideas.[77] First, *Persons* raises a claim of guaranteed access premised on the notion that the first amendment requires the government to make available certain public forums for the expression of ideas.[78] A flat ban on speech in a public forum is impermissible, although the government may impose reasonable time, place, and manner regulations that do not unduly curtail use of the forum.[79] The second issue, a claim of equal access, is based on the idea that

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75. The Supreme Court's decision to begin with a public forum analysis may have resulted from the need to distinguish *Greer* from Flower v. United States, 407 U.S. 197 (1972) (per curiam), upon which the lower court relied. 424 U.S. at 834. *Flower* held that a base commander had lost the right to restrict a civilian from distributing leaflets on a street in the base used extensively by both civilians and the military. *Flower*, 407 U.S. at 198. The Court reasoned that by opening the street to civilian use, the base had abandoned any special interest it might otherwise have had in who was allowed to distribute leaflets on the base. *Id.* The *Greer* Court argued that the military had not similarly abandoned its claim to special control over the base property at Fort Dix. *Greer*, 424 U.S. at 837. Although Fort Dix, similar to the base in *Flower*, permitted civilians to freely enter unrestricted areas of the base, the *Greer* Court argued that the base had nevertheless retained its traditional control over partisan political activity. *Id.* at 837. The *Persons* court may have considered a public forum analysis of the open house necessary in order to distinguish *Flower* and support its extensive reliance upon *Greer*.

76. *See* Ashwander v. Tennessee Valley Auth., 297 U.S. 288, 347 (1936) (Court will not pass on constitutional questions although properly presented if some other ground present upon which case may be disposed) (Brandeis, J., concurring).

77. *See generally* G. GUNTHER, CASES AND MATERIALS ON CONSTITUTIONAL LAW 1196-1200 (10th ed. 1980 & Supp. 1982) (discussing guaranteed and equal access to forums).

78. The concept that there is a guaranteed right of access to certain public forums, such as streets and parks, is generally implied rather than explicitly stated in the Court's public forum cases. *See* Grayned v. City of Rockford, 408 U.S. 104, 115 (1972) (implying guaranteed right of access to some forums by arguing that use of public places for expressive activity may only be restricted, not prohibited); Adderley v. Florida, 385 U.S. 39, 41 (1966) (implying guaranteed right of access to public grounds traditionally open to public).

79. The validity of reasonable time, place, and manner regulations restricting use of public forums is well established. For example, in Cox v. New Hampshire, 312 U.S. 569 (1941), the Court addressed a challenge to a statute prohibiting parades on public streets without a special license. *Id.* at 570-71. The Court had previously, in Hague v. CIO, 307 U.S. 496 (1939), accepted the notion that streets and parks are public forums for expression and that therefore the state cannot abridge the public's right to use them for communicative purposes. 307 U.S. at 516. Although *Cox* also involved the public's right to use of a street for expressive purposes, the Court noted:

> As regulation of the use of the streets for parades and processions is a traditional exercise of control by local government, the question in a particular case is whether that control is exerted so as not to deny or unwarrantedly abridge the right of assembly and the opportunities for the communication of thought and the discussion of public questions immemorially associated with resort to public places.

even if an area is not a public forum with guaranteed access, once the state chooses to open a forum for expressive purposes to some groups, the equal protection clause obligates the state to provide equal access for all similarly situated groups.[80] This section demonstrates that the Eighth Circuit erroneously held that the open house did not create a public forum. Moreover, even if the base was not a public forum on the day of the open house and OAFB could have excluded whole categories of speakers from the base, the Air Force's decision to permit other nonmilitary commercial and ideological groups to participate in the open house entitled PFS to participate as well.

1. The Public Forum: A Guaranteed Right of Access?

The notion that individuals have a guaranteed right of access onto public property historically and traditionally used for the free communication of ideas received its impetus from dictum in the Supreme Court's decision in *Hague v. CIO*.[81] *Hague* held invalid ordinances prohibiting distribution of printed matter and requiring permits to hold public meetings in streets and other public places.[82] Although dictum in an earlier case had suggested that a

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Cox, 312 U.S. at 574.

The notion that access to a public forum is subject to reasonable time, place, and manner restrictions was recently reiterated in Heffron v. International Soc'y for Krishna Consciousness, 452 U.S. 640 (1981). *Krishna* upheld a rule prohibiting the sale or distribution of any materials, including literature, on public fairgrounds except from a licensed location. *Id.* at 654. The Court noted that the first amendment "does not guarantee the right to communicate one's views at all times and places or in any manner that may be desired . . . [rather], activities . . . protected by the First Amendment are subject to reasonable time, place, and manner restrictions." *Id.* at 647. *See also* Grayned v. City of Rockford, 408 U.S. 104, 115-17 (1972) (statute prohibiting noisy disturbances on grounds adjacent to school building during school session upheld as reasonable time, place, and manner restriction); Adderley v. Florida, 385 U.S. 39, 47-48 (1966) (application of trespass statute to prohibit demonstration on premises of jail upheld; Court rejected argument that protestors have constitutional right to protest whenever, however, and wherever they please).

80. Perhaps the best example of this principle is found in Police Dep't of Chicago v. Mosley, 408 U.S. 92 (1972). *Mosley* held unconstitutional on equal protection grounds a statute prohibiting all picketing within 150 feet of a school, except for peaceful labor picketing. *Id.* at 92-93. The Court stated that under the equal protection clause and first amendment,

> government may not grant the use of a forum to people whose views it finds acceptable, but deny use to those wishing to express less favored or more controversial views . . . . There is an "equality of status in the field of ideas," and government must afford all points of view an equal opportunity to be heard. Once a forum is opened up to assembly or speaking by some groups, government may not prohibit others from assembling or speaking on the basis of what they intend to say.

Id. at 96. *See also* Greer v. Spock, 424 U.S. 828, 838-39 (1976) (application of regulations banning all political speech from military base upheld because record showed regulation objectively and evenhandedly applied); *see generally* G. GUNTHER, *supra* note 77, at 1196-1200 (discussing guaranteed and equal access issues).

The government, however, may deny access to certain categories of groups, while granting other groups access to the forum, as long as the prohibition on the category is applied nondiscriminatorily. Thus, in *Greer*, the Court upheld a regulation prohibiting all political groups from campaigning on an army base, even though other civilian speakers, visiting clergy, and entertainment groups had been allowed to enter the base. *Greer*, 424 U.S. at 831. The Court noted that the prohibition had been objectively applied to exclude all political candidates. *Id.* at 839. Similarly, in Lehman v. City of Shaker Heights, 418 U.S. 298 (1974), the Court upheld an ordinance banning all political advertisements from the city's buses even though commercial ads were permitted. *Id.* at 304. The Court noted that all commercial ventures wishing to purchase space were allowed to do so on an equal basis and that no political ads were allowed at all. *Id.* at 303-04.

81. 307 U.S. 496 (1939).

82. *Id.* at 516, 518.

city, as a property owner, was constitutionally free to ban the use of its parks for speech purposes,[83] the *Hague* Court, also in dictum, rejected this concept:

> Wherever the title of streets and parks may rest, they have immemorially been held in trust for the use of the public, and, time out of mind, have been used for purposes of assembly, communicating thoughts between citizens, and discussing public questions. Such use of the streets and public places has, from ancient times, been a part of the . . . rights . . . of citizens. The privilege of a citizen of the United States to use the streets and parks for communication of views on national questions may be regulated in the interests of all; it is not absolute, but relative, and must be exercised in subordination to the general comfort and convenience, and in consonance with peace and good order; but it must not, in the guise of regulation, be abridged or denied.[84]

Since *Hague*, a guaranteed right to use certain public property as a forum for the communication of ideas has been extended beyond streets and parks to protect some forms of free expression occurring on state house grounds,[85] in public libraries,[86] in public schools,[87] and on the streets open to the public within a military base.[88] The Supreme Court has, however, refused to expand the definition of public forum to protect protests occurring on the grounds of jails[89] and courthouses,[90] political advertising on buses,[91] and partisan political activity on closed military bases.[92]

Although several factors influence a public forum finding, an examination of the Court's public forum cases indicates that the major consideration is whether a proposed use of property is compatible with its normal functions, including its historical and traditional uses.[93] The Court explicitly adopted the

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83. *See* Davis v. Massachusetts, 167 U.S. 43, 48 (1897) (upholding preacher's conviction for speaking on city property in violation of ordinance forbidding public addresses on public property).
84. *Hague*, 307 U.S. at 515-16.
85. Edwards v. South Carolina, 372 U.S. 229, 235 (1963).
86. Brown v. Louisiana, 383 U.S. 131, 141-42 (1966).
87. Tinker v. Des Moines Indep. Community School Dist., 393 U.S. 503, 513-14 (1969).
88. Flower v. United States, 407 U.S. 197, 198-99 (1972) (per curiam).
89. Adderley v. Florida, 385 U.S. 39, 47-48 (1966).
90. Cox v. Louisiana, 379 U.S. 559, 562-64 (1965).
91. Lehman v. City of Shaker Heights, 418 U.S. 298, 304 (1974).
92. Greer v. Spock, 424 U.S. 828, 838 (1976).
93. The Court's cases have been read as using either a historical use test, which considers whether the place is historically and traditionally used for purposes of free expression, or an incompatibility standard. This comment argues that, regardless of the label, the Court generally compares the compatibility of a proposed use of a forum with its normal functions, taking into consideration the historical and traditional uses of the forum.

For example, in Brown v. Louisiana, 383 U.S. 131 (1966), the Court reversed the convictions of several defendants who were arrested under a breach of the peace statute after holding a silent protest of segregation policies in a library's reading room. *Id.* at 142-43. The Court reasoned that the first amendment guarantees the right to protest silently in a peaceable and orderly fashion in a place where the protestor has a right to be. *Id.* at 142. Although the Court did not specifically establish a test governing its determination, the decision's rationale supports a conclusion that incompatibility, not historic use, was the deciding factor. The Court noted that libraries are dedicated "to quiet, to knowledge, and to beauty," not to confrontations. *Id.* This suggests that a library, unlike a street or park, is not traditionally a forum for the public, spoken expression of ideas. The Court nevertheless upheld the defendants' right to speak by focusing on the circumstances of the protest. The Court noted that the demonstration had not disturbed the use of the library by others. *Id.* at 142-43. Had it done so, the

issue may have been decided differently. The Court's focus on whether the protest disturbed the normal functioning of the library suggests that the Court perceived the use of the library for a silent and peaceful demonstration against its segregation policies as compatible with the normal uses of the library.

The Court's refusal in Adderley v. Florida, 385 U.S. 39 (1966), to hold that the area surrounding a jail is a public forum, *id.* at 47-48, similarly illustrates the Court's reliance on the incompatibility test. *Adderley* upheld the trespass convictions of students arrested after they refused to end a protest occurring on a nonpublic jail driveway. *Id.* The Court based its decision at least partially on the fact that jail grounds historically have not been open to the public. *Id.* at 41. The Court's rationale, however, also implies that it perceived the protest to be incompatible with the normal functioning of the jail. *Id.* Unlike capitol grounds, a jail is built specifically to fulfill security purposes. *Id.* In addition, the protest occured on a driveway used by the state to transport prisoners to the court and by commercial concerns to service the jail. *Id.* at 45. Thus, unlike the protest in *Brown*, which did not interfere with the library's function, the protest in *Adderley* disrupted the jail's activities and was incompatible with its normal uses.

In Tinker v. Des Moines Indep. Community School Dist., 393 U.S. 503 (1969) the Court upheld the right of several students to wear black armbands in school in protest of the Vietnam War. *Id.* at 513-14. The Court emphasized that wearing the armbands was not disruptive of the normal functioning of the school. *Id.* at 508. The Court also noted that the very idea of student free expression is compatible with the purpose of schools. *Id.* at 512. The *Tinker* Court argued that unlike the library in *Brown*, which was dedicated to the silent expression of thoughts, one of the principal uses to which a school is dedicated is the expression of personal opinions. *Id.* at 513. Expressing protest by wearing armbands was thus compatible with the normal functioning of the school as long as the expression did not materially disrupt the other functions of the school or cause substantial disorder. *Id.*

The Court explicitly adopted the incompatibility test in Grayned v. City of Rockford, 408 U.S. 104 (1972). The *Grayned* Court upheld an ordinance prohibiting a person on the grounds adjacent to a school from willfully disturbing the peace of the school. *Id.* at 117. The Court first reiterated that school property may not be declared totally off limits for purposes of expressive activity. *Id.* at 118. The Court, however, upheld the challenged regulation as a reasonable time, place, or manner restriction narrowly tailored to further the city's compelling interest in an undisrupted school period. *Id.* at 119. In a significant passage, the Court stated that in a public forum challenge, "[t]he crucial question is whether the manner of expression is basically incompatible with the normal activity of a particular place at a particular time." *Id.* at 116. Under this reasoning, quiet and peaceful picketing during school, or more boisterous picketing before or after school, arguably would be constitutional because it would in no way disturb the functioning of the school. *Id.* at 120.

The Court in Lehman v. City of Shaker Heights, 418 U.S. 298 (1974), implicitly used an incompatibility rationale. The *Lehman* Court upheld a municipal policy prohibiting political advertising but allowing commercial advertising on city buses. *Id.* at 304. The Court noted that the determination of whether an area is a public forum is dependent on the nature of the forum and the conflicting interests being asserted. *Id.* at 302-03. The Court reasoned that because the city was engaged in commerce, it had an interest in providing pleasant and inexpensive service to its customers. *Id.* at 303. The Court, however, perceived political ads to be incompatible with the proprietary goals of the city.

Even when the Court has expressly relied on an historical use test, it has implicitly invoked the compatibility standard. For example, in United States Postal Service v. Council of Greenburgh Civic Assn's, 453 U.S. 114 (1981), the majority found that a letterbox was not constitutionally or historically a public forum, stating that "letter boxes are an essential part of the nationwide system for the delivery and receipt of mail, and since 1934 access to them has been unlawful except under the terms and conditions specified by Congress and the Postal Service." *Id.* at 128-29. In its answer to Justice Brennan's concurrence, however, the Court indicated that it was precisely because this historic use was incompatible with the public use of mailboxes that public forum status had been denied. *See id.* at 130 n.6 (Court states that public use of letterboxes "wholly incompatible" with the national mail delivery system in response to concurring opinion's assertion that letterboxes are public forums because public use not incompatible with use by postal service). Thus, in employing the historic use test, the Court apparently made an implicit analysis of the compatibility of the public and historic uses.

In addition, *Greer*, heavily relied on by the *Persons* majority, has been criticized for conducting a "veiled incompatibility inquiry" via the historical use test and failing to address the actual impact of political activity on the government's national defense and nonentanglement interests. *The Supreme Court, 1975 Term*, 90 HARV. L. REV. 56, 156 (1976). *See also Greer*, 424 U.S. at 843 (Powell, J. concurring) (*Grayned* compatible use test appropriate test for analyzing regulation of civilian expression on military base). Commentators Zillman and Imwinkelried also have attacked the historical use test for obscuring the question of how a proposed public activity will actually interfere with the government interest at issue. Zillman & Imwinkelried, *supra* note 26, at 787.

incompatibility test in *Grayned v. City of Rockford*,[94] which upheld an anti-noise ordinance governing disturbances near schools,[95] and has implicitly used the incompatibility test in its other public forum cases.[96] The Eighth Circuit nonetheless argued that the Supreme Court's decision in *Greer* illustrates that a determination of whether public property is a public forum rests solely on the historical use test, and thus the majority considered only whether the Air Force had abandoned its historical and traditional uses of the base for the duration of the open house.[97]

An analysis of the rationale in *Greer*, however, indicates that the *Persons* court mistakenly characterized the standard that the Supreme Court used in that case. *Greer*, in upholding a military base regulation prohibiting partisan political activity on the base, noted that a military base has not traditionally served as a place for free public assembly and communication of thoughts.[98] Although this statement suggests that the Court was utilizing a historical use test to determine whether the Army base was a public forum, the *Greer* Court's analysis suggests that its holding was premised on the notion of incompatibility. The Court emphasized that it is the primary business of a military installation to train soldiers.[99] Guaranteeing access to the base as a public forum would therefore have interfered with the primary purpose to which the base was dedicated.[100] The Court also viewed the prohibition on use of the base for political activity as consistent with the military's policy of political neutrality.[101] The *Persons* court thus failed to recognize that *Greer* actually considered the compatibility of the proposed use of the base with its traditional use as a politically neutral area set aside to train soldiers.

The Eighth Circuit's determination that the open house at OAFB did not create a public forum was based on this erroneous reading of *Greer*. Relying on the historical use test, the *Persons* court concluded that the open house was "within the range of traditional military activities" and thus the Air Force had not abandoned its status as a nonpublic forum.[102] Because the *Persons* court failed to analyze the public forum issue under an incompatibility test, however, it failed to consider PFS' speech on the basis of its compatibility with the purpose of the open house. In *Greer*, the Court suggested that political campaign speeches were incompatible with the basic training function of the base and with the tradition of political neutrality that requires a separation of the military and civilian sectors.[103] In contrast, the open house at OAFB is a delib-

94. 408 U.S. 104 (1972). *See supra* note 93 (discussing *Grayned*).
95. *Grayned*, 408 U.S. at 117.
96. *See supra* note 93 (discussing implicit use of incompatibility standard in public forum cases).
97. *Persons*, 675 F.2d at 1015.
98. *Greer*, 424 U.S. at 838.
99. *Id.*
100. *Cf.* Grayned v. City of Rockford, 408 U.S. 104, 120 (1972) (upholding anti-noise ordinance prohibiting willful disturbances on grounds adjacent to school during school hours; although noisy demonstrations may be constitutionally protected at other places or times, they may be prohibited next to school during class hours); Brown v. Louisiana, 383 U.S. 131, 142 (1966) (peaceful demonstration in library protected by first amendment when protest did not disturb others' use of library or library's activities).
101. *Greer*, 424 U.S. at 839.
102. 675 F.2d at 1017.
103. *Greer*, 424 U.S. at 839.

erate suspension of the training activity of the base and of the separation between the military and civilian sectors. For one day, the military stops functioning as it normally does and explicitly invites the public onto the base so that the military can engage in recruitment and community relations activities. The objective is interaction, not separation. In contrast to the closed base in *Greer*, free expression is wholly compatible with the purposes of the open house and with the activities of the base on the day of the open house. Consequently, the *Persons* court should have concluded that the open house constituted a temporary public forum, and that PFS had a guaranteed right of access to the base.

The *Persons* court's further argument that a place does not become a public forum solely because it is used for the communication of ideas[104] fails to distinguish between the guaranteed and equal access claims to use of a forum. The Eighth Circuit cited *United States Postal Service v. Council of Greenburgh Civic Associations*[105] to support the proposition that the open house did not transform the base into a public forum.[106] The *Greenburgh* Court, which upheld the constitutionality of a postal regulation prohibiting the deposit of unstamped letters in mailboxes,[107] reasoned that an instrumentality does not become a public forum solely because it is used for the communication of ideas.[108]

Citing *Greenburgh* to support the proposition that the public is not guaranteed access onto military bases solely because the government speaks on the base every day is probably valid. A reading of the Court's public forum cases supports the view that a public forum is not created solely because an area is used for communication but depends instead on the compatibility of the expression with the normal functions of an area.[109] The *Persons* majority, however, ignored the fact that not only the government, but nonmilitary groups as well, expressed their views at the open house. The selective exclusion of PFS thus transforms the issue of guaranteed access into an issue of equal access. Under an equal access challenge, it is irrelevant whether or not the use of public property has created a public forum. The issue becomes instead whether the government, once it has opened up an area, can selectively exclude groups from its use. The majority's argument that the military's engagement in ideological speech was not sufficient by itself to turn the open house into a public forum is meaningless because the government did not choose to ban completely all other speech by civilian groups.

2. Equal Access Claim

As an alternative to the public forum approach, PFS argued that its exclusion violated the right to equal access to the base.[110] The Eighth Circuit, in rejecting this claim, first recognized that speech on property that is not a public

104. 675 F.2d at 1017.
105. 453 U.S. 116 (1981). *See supra* note 28 (discussing *Greenburgh*).
106. *Persons*, 675 F.2d at 1017.
107. 453 U.S. at 131.
108. *Id.* at 130 n.6.
109. *See supra* note 93 (discussing Supreme Court's use of incompatibility test).
110. *Persons*, 675 F.2d at 1018.

forum may be subject to regulation as long as the restrictions imposed are reasonable and content neutral.[111] The *Persons* court, however, collapsed both requirements into a reasonableness test by giving extreme deference to the decision of the base commander.[112] The Eighth Circuit's analysis of the base commander's decision suffers from two defects. First, because it relied solely on a standard of reasonableness, it erroneously accorded great deference to the base commander. Second, the *Persons* court failed to properly apply and analyze the content-neutrality requirement.

Deference to the Commander. The Eighth Circuit improperly deferred to the base commander's decision to exclude PFS from the open house by analogizing the commander to a prison administrator. The *Persons* court relied on *Jones v. North Carolina Prisoner's Labor Union*,[113] which upheld a prison administrator's discretionary distinctions among groups to receive bulk mailing and meeting privileges, to make its analogy.[114] The *Persons* court, however, did not fully analyze the reasoning behind the deference granted to the prison administrator in *Jones*. The *Jones* Court emphasized that incarceration necessarily carries with it the withdrawal or limitation of a prisoner's rights.[115] Although a prisoner retains some rights, the state may legitimately curtail other rights and permit the exercise of only those rights consistent with the legitimate policies and goals of a corrections system.[116] The *Jones* Court deferred to the administrator's determination of the limitations on prisoners' rights necessary to maintain the security and order of the prison in recognition of the administrator's expertise in the complexities of running a penal institution.[117]

The *Persons* court's reliance on *Jones* to support the proposition that a court must defer to the decisions made by a base commander is misplaced. Significantly, *Jones* involved a decision limiting the rights of prison inmates, whereas *Persons* limited the expressive rights of civilians. The Supreme Court recognized the significance of this distinction in *Procunier v. Martinez*.[118] In *Martinez*, the Court struck down mail censorship regulations proscribing prisoner correspondence that unduly complained, expressed inflamatory beliefs, or was otherwise considered inappropriate.[119] The *Martinez* Court noted that courts have traditionally adopted a broad "hands-off" attitude towards problems of prison administration.[120] The challenged censorship regulations, however, implicated the first amendment rights of the citizens who received a prisoner's mail, as well as the rights of the prisoners.[121] The Court therefore held that the

111. *Id. See Greenburgh*, 453 U.S. at 131 n.7 (restrictions on speech in nonpublic forum must be reasonable and content neutral).
112. *Persons*, 675 F.2d at 1018. The court relied on the historical deference afforded by courts to military base commanders. *Id.*
113. 433 U.S. 119 (1977).
114. *Persons*, 675 F.2d at 1018.
115. *Jones*, 433 U.S. at 125-27.
116. *See infra* note 139 (citing cases dealing with restricted rights of inmates).
117. *Jones*, 433 U.S. at 126.
118. 416 U.S. 396 (1974).
119. *Id.* at 416.
120. *Id.* at 404.
121. *Id.* at 411.

censorship of prisoner mail could be justified only if the regulation furthered important governmental interests unrelated to the content of the expression and if the limitation was no greater than necessary to protect the governmental interests.[122]

To the extent that the prison analogy is applicable to the OAFB open house, the *Martinez* situation is more analogous to *Persons* than is *Jones*. Like the prison administrator's decision in *Martinez*, which affected both inmates and civilians, the base commander's decision in *Persons* circumscribed the rights of citizens it had specifically invited onto the base as well as the rights of resident military personnel. In *Jones* the prison administrator's decision affected only inmates. The *Persons* court should have accordingly subjected the OAFB commander's decision to the higher scrutiny given to the prison administrator's decision in *Martinez*, rather than the minimal scrutiny in *Jones*.[123]

The *Persons* court also relied on *Cafeteria and Restaurant Workers Union v. McElroy*[124] to support its deference to the base commander's decision. In *Cafeteria Workers* the Court deferred to a naval commanding officer's decision to exclude an employee from a sensitive weapons development facility when the employee did not meet security requirements.[125] The Court argued that it is a well-settled fact that a military commander may summarily exclude civilians from the area of his command.[126]

The *Persons* situation, however, is distinguishable from *Cafeteria Workers*. Although the Court deferred to the base commander's decision in *Cafeteria Workers* to exclude a civilian from the base, the excluded civilian nevertheless was employed by the military to work in a security-based facility.[127] The military thus had a substantial interest in requiring the civilian to satisfy its security requirements. The commanding official, not the court, was in the best position to determine whether an employee presented a security risk. In contrast, OAFB had chosen to open its facilities to all members of the public on the day of the open house. OAFB cannot contend, therefore, that PFS' exclusion was necessary to ensure the security of the already-opened base. Moreover, even if the commander feared that PFS would pose a greater security risk than other groups, the Supreme Court has held that a generalization that speech will provoke the reaction of a hostile audience does not support a limitation of expression.[128] Because PFS had agreed to abide by established time,

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122. *Id.* at 413.

123. Several commentators have criticized the tradition of judicial deference to the military when an issue arises involving the interaction of the military with civilians. *See generally* Shiffrin, *supra* note 26; Zillman and Imwinkelried, *supra* note 26; Note, *Free Speech and the Armed Forces: The Case Against Judicial Deference*, 53 N.Y.U. L. REV. 1102 (1978).

124. 367 U.S. 886 (1961).

125. *Id.* at 893-94.

126. *Id.* at 893.

127. *Id.* at 887.

128. In a line of cases dealing with the "hostile audience" argument, the Court has generally overturned disorderly conduct convictions when the authorities merely feared that the speaker's speech would provoke violence or cause a loss of control over the audience. *See, e.g.*, Gregory v. City of Chicago, 394 U.S. 111, 111-12 (1969) (reversing conviction of peaceful civil rights demonstrators arrested for disorderly conduct when protestors' arrest stemmed from anticipation by police of civil disorder after bystanders became unruly); Cox v. Louisiana, 379 U.S. 536, 547, 550 (1965) (reversing conviction of civil rights demonstration leader for disturbing the peace when record did not indicate mood of protest was hostile or aggressive, or that protesters were violent, and when any threat of

place, and manner regulations,[129] a prior restraint of their participation based on vague security concerns was unjustified.

The inquiry into the degree of deference to be granted to certain public officials should focus on the important state interests and factual circumstances surrounding an official's exercise of discretion. When important state interests support strict control of an area and its personnel for security and order purposes, a decision to regulate expression is best made by those familiar with the forum, its purposes, and the people interacting within its confines. Accordingly, such officials should be granted a greater degree of deference to make decisions affecting only the personnel connected with those forums. When, however, a decision implicates the free speech rights of both personnel and citizens not necessarily connected with the forum, a similar justification does not exist for deferring to the judgment of the administrator.[130] By granting excessive deference to the base commander, the *Persons* court failed to examine the reasonableness of the commander's decision and to apply properly the content-neutrality requirement.

The Content-Neutrality Requirement. In addition to the reasonableness requirement, the Supreme Court requires that a regulation limiting speech in a nonpublic forum be content neutral.[131] Government restrictions on free speech

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violence was based only on officials' fear of hostile audience reaction); Edwards v. South Carolina, 372 U.S. 229, 232-33, 236 (1963) (reversing convictions of protestors arrested for breach of peace when no violence or threat of violence on part of protestors or crowd existed and when police protection was sufficient to meet any foreseeable possibility of disorder); Terminiello v. Chicago, 337 U.S. 1, 4-5 (1949) (reversing conviction of leader of protest arrested for breach of peace when statute allowed arrest merely because speech stirred audience to anger). *See also* Tinker v. Des Moines School Dist., 393 U.S. 503, 505 (undifferentiated fear or apprehension of disturbance not sufficient to overcome right to free speech). *But see* Feiner v. New York, 340 U.S. 315, 316-18 (1951) (upholding conviction of speaker for breach of peace when only one to two police officers had to control crowd of around 80 people, one fight had broken out, and crowd was pressing closer and closer to speaker and officers).

129. *Persons*, 675 F.2d at 1012.

130. The *Persons* court's analysis of the reasonableness of the base commander's decision was very cursory. The court argued that participation by the Chamber of Commerce was reasonably related to the community relations purpose of the open house. 675 F.2d at 1019. The exclusion of PFS arguably implies that a group advocating a position in opposition to the military, unlike the Chamber of Commerce, does not serve to "show the community the relationship" between national defense objectives and the base, the stated purpose of the open house. This reasoning assumes that only those who favor the Air Force's defense mission are able to present to the community an accurate picture of the national defense. The argument that selective exclusion of one side of the national defense debate constitutes unconstitutioal viewpoint regulation is discussed *infra* notes 136-142 and accompanying text.

The majority also argued it was reasonable for the commander to distinguish between defense contractors and PFS. *Persons*, 675 F.2d at 1019. Under the *Persons* court's analysis, the defense contractors' participation was consistent with the purposes of the open house because they presented "blandly informative displays" of *current* weapons systems and also because the contractors were involved in the daily activities of the base. *Id.* The majority's reliance on the fact that the defense contractors displayed only current weaponry is troubling because the commander denied PFS' application without determining whether PFS' displays would also concentrate solely on current weapons systems. *See id.* at 1014 (after denial of injunction, district court found no evidence on remand that base commander received or reviewed PFS' literature before denying permission to participate). This similarly serves to illustrate that the commander based the denial on the views about current weapons PFS wished to express, rather than on the kinds of weapons on which PFS wished to present information.

131. The requirement that a regulation restricting expression be content neutral is premised on the notion that content neutrality assures that free expression remains unabridged. Free expression is necessary to achieve such important goals as individual self-fulfillment, attainment of the truth, participation in decisionmaking, and balance between the forces for stability and change. *See generally* Emerson, *Toward a General Theory of the First Amendment*, 72 YALE L. REV. 877, 879-85 (1963) (dis-

in a nonpublic forum may unconstitutionally abridge the requirement of content neutrality in two ways. First, the state may attempt to impose a restriction on free expression based on the content of a speaker's views.[132] Second, the government may attempt to restrict discussion of an entire subject matter.[133] Although the Supreme Court has permitted exceptions to the proscription against subject matter regulation in narrow circumstances,[134] the Court has

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cussing function of free expression in democratic society). The Supreme Court has often recognized the efficacy of one or more of these functions when discussing first amendment freedom. *See, e.g.*, Cohen v. California, 403 U.S. 15, 24 (1971) (constitutional right of free expression designed to put decision as to what news shall be voiced largely in hands of individual in hope freedom will produce more capable citizenry); New York Times Co. v. Sullivan, 376 U.S. 254, 270 (1964) (profound national commitment to principle that debate on public issues should be uninhibited, robust, and wide-open); Terminiello v. Chicago, 337 U.S. 1, 4 (1949) (function of free speech is to invite dispute); Musser v. Utah, 333 U.S. 95, 101 (1948) (Rutledge, J., dissenting) (democratic society may not deny its citizens the right to criticize existing laws and urge they be changed).

132. Consolidated Edison Co. v. Public Serv. Comm'n, 447 U.S. 530, 537 (1980).

133. *Id.*

134. A recent line of cases adopts a narrow subject matter exception to the content-neutrality requirement. This exception seemingly permits a subject matter to be barred from a facility if expression of the subject matter would disrupt the legitimate governmental purpose to which the property has been dedicated. *Id.* at 538. Although a broad reading of this exception seemingly permits the government to regulate speech solely on the basis of content, a narrower reading suggests the Court actually undertakes a balancing of interests before it allows the restrictions. Subject matter restrictions are permissible under this narrower reading only if a substantial governmental interest outweighs the infringement of free expression. For example, in Greer v. Spock, 424 U.S. 828 (1976), the Court upheld a military base commanding officer's rejection of a request to distribute campaign literature and hold a political rally. *Id.* at 838. The Court argued that the public interest in protecting military political neutrality outweighed the value of free political expression directed at the military community. *Id.* at 839. In his concurrence, Justice Powell also argued that the infringement was justified in light of the strong public interest in political neutrality and the fact that alternative means of communicating with the servicemen existed. 424 U.S. at 845-48 (Powell, J., concurring). Thus, although the regulation challenged in *Greer* suppressed an entire subject matter, political expression, it arguably restricted speech no more than was reasonably necessary to protect what the Court categorized as a substantial governmental interest.

Similarly, in Jones v. North Carolina Prisoner's Labor Union, 443 U.S. 119 (1977), the Court upheld challenged prison regulations denying bulk mailing and meeting privileges to a prisoner's union. *Id.* at 122, 136. The Court held that the regulations, which applied only to the union, were consistent with legitimate operational considerations of the institution. *Id.* at 130. In addition, the Court found that prison officials had a reasonable basis for determining that the union, unlike groups such as Jaycees and Alcoholics Anonymous, posed additional and unwarranted problems and frictions in the operation of the prison. *Id.* at 129. The balance of interests thus arguably favored the government because of the prisoners' diminished first amendment rights and the legitimate state interests in operating a correctional institution.

In Lehman v. City of Shaker Heights, 418 U.S. 298 (1974), the plurality did not explicitly balance interests. Instead, the decision emphasized that the state was engaging in commerce and not primarily regulating speech. *Id.* at 303-04. The *Lehman* Court held that a city may constitutionally ban all political advertising from its vehicles while accepting commercial advertising. *Id.* at 304. The Court deemed the city's interests in producing revenue from long-term commercial advertising, in avoiding risks associated with charges of political favoritism, and in preventing the creation of captive audience problems adequate reasons for the managerial policy. *Id.* The Court also found it significant that all political ads were banned and that all commercial ads received equal treatment. *Id.* at 303-04.

The *Lehman* decision is somewhat troubling because the Court seemingly ignored the issue of whether the state's interest in suppressing a subject matter was legitimate. The opinion, however, arguably has limited precedential value. Four dissenting Justices argued that it was unconstitutional to distinguish between commercial and political advertisers. *Id.* at 310 (Brennan, J., with Stewart, Powell & Marshall, JJ., dissenting). In addition, Justice Douglas concurred in the result only because he perceived a captive audience problem in permitting any subject matter to be advertised on city buses. *Id.* at 306-08 (Douglas, J., concurring). *See* Karst, *Equality as a Central Principle in the First Amendment*, 43 U. CHI. L. REV. 20, 34-35 (1975) (criticizing *Lehman* Court's suggestion that proprietary role of city is significant in first amendment case); Stone, *Restrictions of Speech Because of its Content: The Peculiar Case of Subject Matter Restrictions*, 46 U. CHI. L. REV. 81, 91-92 (1978) (discussing weakness of *Lehman* argument that equal treatment across subject matter justifies content-based regulation).

never allowed viewpoint regulation. Rather, the Court has held that once the government opens a forum for the communication of ideas, both the first amendment and the equal protection clause prohibit discrimination among groups on the basis of the viewpoints of the speakers.[135]

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135. The Court expressed its disapproval of viewpoint regulation in an early public forum case, Niemotko v. Maryland, 340 U.S. 268 (1951). In *Niemotko*, the Court held that the arbitrary and discriminatory refusal to grant the Jehovah's Witnesses prior permission to use a public park violated the equal protection clause when such permission generally was granted to other groups, including religious organizations. *Id.* at 273. The Court noted:

> The conclusion is inescapable that the use of the park was denied because of the city council's dislike for or disagreement with the Witnesses or their views. The right to equal protection of the laws, in the exercise of those freedoms of speech and religion protected by the First and Fourteenth Amendments, has a firmer foundation than the whims or personal opinions of a local governmental body.

Id. at 272.

The notion that the equal protection clause and the first amendment prohibit the government from regulating speech on the basis of viewpoint once the state has opened a forum has been prevalent in the Court's cases. *See, e.g.,* Widmar v. Vincent, 454 U.S. 263, 276-77 (1981) (state university policy prohibiting use of buildings or grounds for purposes of religious worship or teaching violates constitutional principle that regulation of speech must be content-neutral when facilities generally open for other activities; equal access policy would not be incompatible with establishment clause and interest in separation of church and state not sufficiently compelling to justify content-based restriction); Carey v. Brown, 447 U.S. 455, 471 (1980) (statute generally prohibiting picketing of residences or dwellings but permitting peaceful labor picketing violates equal protection clause; statute discriminated among pickets based on subject matter of expression); First Nat'l Bank v. Bellotti, 435 U.S. 765, 784-85 (1978) (statute prohibiting specified corporations from making contributions for purpose of influencing voters unless matter materially affected corporation violates first amendment; restriction suggested attempt to give one side of debatable public question an advantage in expressing its views); City of Madison Joint School Dist. v. Wisconsin Employment Relations Comm'n, 429 U.S. 167, 175-76 (1976) (employment commission's order to school board to stop permitting school employees other than union officials from speaking on collective bargaining at board meetings violates first amendment; once state opened forum for direct citizen involvement, school could not be ordered to discriminate among speakers on basis of content of speech); Erznoznik v. City of Jacksonville, 422 U.S. 205, 210 (1975) (ordinance making it public nuisance for drive-in movie theater to exhibit films containing nudity if screen visible from public street violates first amendment; ordinance discriminated among movies solely on basis of content); Cox v. Louisiana, 379 U.S. 559, 580-81 (1965) (Black, J., concurring) (statute prohibiting obstruction of public passages except for legitimate labor picketing violates first and fourteenth amendments; state attempting to pick and choose among views discussed on streets).

The cases prohibiting viewpoint regulation rely heavily on the equal protection clause, resulting in a high level of scrutiny of statutes discriminating among viewpoints. For example, Police Dep't of Chicago v. Mosley, 408 U.S. 92, 95 (1972), involved a challenge to a city ordinance prohibiting all picketing within 150 feet of a school except for peaceful labor picketing. *Id.* at 92-93. The Court rejected the city's argument that the statute was a reasonable time, place, and manner regulation, reasoning instead that the ordinance violated the fourteenth amendment's equal protection clause by impermissibly distinguishing between peaceful labor picketing and other picketing on the basis of its content. *Id.* at 99. In the course of the opinion, the Court noted:

> Necessarily then, under the Equal Protection Clause, not to mention the First Amendment itself, government may not grant the use of a forum to people whose views it finds acceptable, but deny use to those wishing to express less favored or controversial views. And it may not select which issues are worth discussing or debating in public facilities. There is an "equality of status in the field of ideas," and government must afford all points of view an equal opportunity to be heard. Once a forum is opened up to assembly or speaking by some groups, government may not prohibit others from assembling or speaking on the basis of what they intend to say.

Id. at 96. The Court invalidated the statute despite the school's legitimate interest in preventing school disruption because the statute, in permitting all labor picketing, was not narrowly drawn to achieve the state's legitimate goal. *Id.* at 92-93.

The Court continues to use the *Mosley* Court's strict scrutiny of restrictions on speech when the government has opened a forum to the communication of ideas. *See, e.g.,* Widmar v. Vincent, 454 U.S. 263, 269-70 (1981) (having created a forum generally open for use by student groups, university re-

The *Persons* court argued that the commander's exclusion of PFS was a legitimate subject matter regulation.[136] The court, however, improperly categorized PFS' exclusion. PFS, like the military, its civilian leaders, and the defense contractors, sought to speak on national defense policies. PFS and the groups permitted access to the base thus sought to express ideas on the same subject matter; only their points of view differed. By excluding PFS, therefore, the government effectively silenced one side of the national security debate, rather than silencing a whole subject matter of discussion. The *Persons* court should have recognized that PFS' exclusion constituted unconstitutional viewpoint regulation and upheld the equal access claim.

The Eighth Circuit's failure to recognize that exclusion of PFS permitted unconstitutional viewpoint regulation illustrates a fundamental difference between PFS' guaranteed and equal access claims that the *Persons* court seemingly ignored. Although the government is arguably free to exclude all communication of ideas from a nonpublic forum, it is not similarly free to discriminate among groups once it has opened the forum. If OAFB had remained a closed base every day of the year, or if only government military organizations had been permitted to participate in the open house, PFS' exclusion probably would have been permissible. The base commander, however, purposefully invited the public onto the base and permitted nonmilitary organizations to participate in the open house if they espoused the government's current view of what the national defense policy should be. The Air Force violated PFS' equal protection rights by opening the base to allow such participation and denying PFS entrance to the base solely because the group's views were opposed to those of government. The determination by the commander that PFS' views were inconsistent with the community relations purpose of the open house thus should never have been made. Once OAFB opened the base for speech, the views of PFS were irrelevant, and arguably impermissible to consider, because the first amendment requires the governmment to heed the "equality of status in the field of ideas."[137]

The Eighth Circuit also argued, mistakenly under its public forum analysis, that the base commander was free to silence viewpoints opposing the military because any government speech at the open house represented the civilian

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quired to justify exclusion from forum based on religious content of speech by showing regulation necessary to serve compelling state interest and narrowly drawn); Carey v. Brown, 447 U.S. 455, 461-62 (1980) (when government regulation discriminates among speech-related activities in a public forum, equal protection clause mandates that legislation be finely tailored to serve substantial state interests, and that justifications for distinctions be carefully scrutinized).

136. 675 F.2d at 1018. The court reached its conclusion without explicitly comparing the subject matter of PFS' speech with that of the nonmilitary open house participants. Rather, the Eighth Circuit appeared to focus on the relationship of the groups to OAFB, although it did not specify how the safety groups and the Chamber of Commerce bore a greater relationship to the base than did PFS. Nonetheless, the court concluded that the exclusion of PFS was reasonable in view of the community relations purpose of the open house. *Id.* at 1019-20.

By failing to compare the subject matters of all the groups and relying instead on whether the group's presence would promote good community relations, the court upheld a standard which allowed the exclusion of a group (PFS) merely because the Air Force determined that the group was critical of Air Force policies. *See supra* note 130 (discussing *Persons* court's deference to base commander's decision and resulting viewpoint regulation).

137. Police Dep't of Chicago v. Mosley, 408 U.S. 92, 96 (1972).

mandate regarding national defense.[138] This reasoning, however, does little to dispel the viewpoint regulation objection. First, it disregards the participation of the various nonmilitary groups and the resulting viewpoint discrimination. Second, the *Persons* court's argument fails to recognize that the first amendment's protection of individual speech may require some restrictions on government speech. The first amendment protects individual free expression from unwarranted governmental intrusions designed to silence views inimical to those in power.[139] The amendment thus arguably offers less protection to the speech of the government itself than to the speech of citizens.[140] Although the military may be under a civilian mandate, the civilians who run the military (the President and Congress) are governmental actors. Thus, whether the speech at the open house represented the military's ideology or reflected only the mandate of its civilian leaders, the Air Force was engaged in government speech.[141] Although PFS does not necessarily have a right to prevent the government from expressing its own ideology,[142] PFS arguably has a right consis-

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138. *Persons*, 675 F.2d at 1017-18.

139. *See generally* T. EMERSON, THE SYSTEM OF FREEDOM OF EXPRESSION 697 (1970) (noting that attention usually focused on obligation of government to refrain from interfering with rights of private participants in system of freedom of expression); Alstyne, *The First Amendment and the Suppression of Warmongering Propaganda in the United States: Comments and Footnotes*, 31 LAW & CONTEMP. PROBS. 530, 532 (1966) (private political discussion protected from government abridgement to restrain those in power from perpetuating policies through suppression of ideas inimical to their own); Tribe, *Toward a Metatheory of Free Speech*, 10 SW. U.L. REV. 237, 244 (1978) (free speech theory must be discerning enough to distinguish governmental voice that merely adds to public debate from governmental voice that monopolizes it); Yudof, *When Governments Speak: Toward a Theory of Government Expression and the First Amendment*, 57 TEX. L. REV. 863, 867 (1979) (historic purpose of first amendment to limit government speech).

140. The argument that government speech is entitled to less first amendment protection than individual speech centers around the notion that the power of government and its access to the communications media enables it to act as an extremely powerful censor of ideas inimical to its own. *See* T. EMERSON, *supra* note 139, at 698 (although government participation in free expression essential to democratic society, it also brings serious dangers because speech emanates from source of great authority, government controls many information sources, and no independent institutions guard against abuse); Yudof, *supra* note 139, at 865 (power of government to communicate is also power to indoctrinate); *see generally* Shiffrin, *supra* note 26 (arguing limits of content and structure need to be placed on government speech).

141. This comment adopts Professor Shiffrin's definition of government speech, which was also employed by the *Persons* court. Professor Shiffrin defines the term government speech to include all forms of state-supported speech, whether or not it is actually or perceived to be endorsed by the government. Shiffrin, *supra* note 26, at 565 n.*. Even under a less broad definition, the speech at OAFB would be government speech because it was both state supported and endorsed.

142. According to one commentator, the central problem of government speech is the determination of when and by what means government may promote controversial values. Shiffrin, *supra* note 26, at 570. Although Professor Shiffrin does not maintain that the government should always remain neutral, or that it should never restrict others from speaking, he urges that a structure must be developed to determine when competing values outweigh the government's interest in communication. *Id.* at 588, 606, 610. Under this view, the Eighth Circuit should at least have explained how the governmental interest asserted by the Air Force, the need to demonstrate use of tax dollars, outweighed PFS' first amendment rights.

Other commentators have similarly recognized the need to undertake a more detailed analysis of the problem of excessive governmental regulation of expression. *See* T. EMERSON, *supra* note 139, at 699 (observing that when government monopolizes expression by virtue of its powers or function, "antithesis of a system of free expression" results); Yudof, *supra* note 139, at 873 (proposing that government expression be explicitly factored into first amendment cases and suggesting that courts create constitutional presumption of right of access to public institutions that could only be defeated by pressing institutional needs). Another author, recognizing the inherent power of the military-industrial complex to influence policy, argues that

tent with equal protection and the first amendment of equal access to express its own views to counter those of the powerful and omnipresent government.

Even if the *Persons* court correctly characterized PFS' exclusion as subject-based, the court failed to conduct the necessary analysis to support its finding of such an exception. In the cases in which the Supreme Court has allowed a subject-based exception to the content-neutrality requirement, the Court has found a significant state interest which justified the regulation.[143] For example, in *Jones* the Court made a subject-based exception to the content-neutrality requirement[144] only after it had analyzed the state's interest in suppressing the subject matter. The *Jones* Court held that the peculiar circumstances and motivations surrounding incarceration created a substantial state interest in controlling prisoners' free speech and associational rights.[145] The Court has recognized the uniqueness of the prison context as a persuasive rationale for limiting or abolishing many of the rights of prisoners, including those arising under the first amendment.[146] In addition, the Court based its approval of the exclusion of political speech in *Greer* upon the recognition of the state's important interest in maintaining the military's neutrality.[147] Thus, although each of the cases upheld a subject-based exclusion, the Court had carefully scrutinized the substantial state interest in imposing the restriction.

The *Persons* court, in contrast, never analyzed the substantiality of the state's interest in excluding PFS. If the court had undertaken the required review of state interests, the exclusion of PFS would not have been upheld as a permissible subject-based exclusion. In general, the state arguably retained a substantial interest in controlling the flow of people and uses of the military base. A military base, similar to a prison, is designed for a narrow, specific purpose (to train soldiers) that requires a great deal of state control if legitimate institutional goals are to be met.[148] Military personnel on a base, similar

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> the coincidence of interest among military men, defense contractors, labor unions and politicians, not to mention bankers, lawyers and public relations types, is so clear that no conspiracy theory is required to predict its consequences in encouraging expansion of the military establishment and restraining criticism of defense spending.

Yarmolinsky, *supra* note 26, at 658.

143. *See supra* note 134 (discussing Court's balancing of state interests and free speech rights in allowing subject-based exclusions from non-public forums).

144. *Jones*, 433 U.S. at 132-34.

145. *Id.* at 132-33.

146. *See, e.g., id.* at 125-26, 130, 132-33 (upholding regulations prohibiting inmates from soliciting other inmates to join prisoner's labor union and barring bulk mailing and meeting privileges; Court recognized that circumstances of penal confinement and needs of institution impose limitations on constitutional rights, including those derived from first amendment, and that regulations were consistent with prisoners' status); Meachum v. Fano, 427 U.S 215, 224-25 (1976) (due process clause does not entitle convicted state prisoner to factfinding hearing when he is transferred to prison where conditions are substantially less favorable to him; Court reasoned that given valid conviction, state free to confine defendant without implicating any liberty interest as long as constitutional requirements fulfilled); Pell v. Procunier, 417 U.S. 817, 822, 828 (1974) (upholding provision prohibiting press and other media interviews with specific individual inmates; Court recognized that prison inmate retains only those first amendment rights not inconsistent with status as prisoner or with legitimate penological objectives); *cf.* Procunier v. Martinez, 416 U.S. 396, 416 (1974) (invalidating mail censorship regulations restricting inappropriate correspondence by inmates because regulations authorized censorship broader than legitimate interests of penal administration).

147. *Greer*, 424 U.S. at 839.

148. *Greer*, 424 U.S. at 838; Parker v. Levy, 417 U.S. 733, 743 (1974); United States *ex rel.* Toth v. Quarles, 350 U.S. 11, 17 (1955).

to prisoners, are correspondingly subjected to more strict limitations of their rights than are ordinary civilians.[149] The state thus had legitimate state interests supporting the restriction of speech on the base.

Unlike the regulation involved in either *Jones* or *Greer*, however, the restrictive regulation at issue in *Persons* implicated the right to address the civilian population. Although the state may have a substantial interest in restricting first amendment speech directed at military personnel and prisoners, it hardly follows that it has a similarly substantial interest in restricting free speech targeted at civilians.[150] Moreover, even if the military may generally restrict civilian rights for purposes of security once the civilian enters the base, it is difficult to argue that OAFB retained this substantial interest in security in the context of an open house attended by 250,000 civilians. The *Persons* court failed to articulate the substantial state interests which supported PFS' exclusion as a narrow subject-based exception to the content-neutrality requirement.

CONCLUSION

Persons for Free Speech at SAC v. United States Air Force is an unsound decision. The majority both upheld the Air Force's discriminatory application of its own regulation and substantially ignored the constitutional doctrines on which the protection of freedom of speech depends. The Eighth Circuit repeatedly deferred to the decision of the base commander rather than undertaking its own rigorous analysis of the state interests justifying PFS' selective exclusion from the open house. Regardless of the historic deference given to decisions of the military, the court should have determined what measure of deference was appropriate in view of the fact that civilian, not military, first amendment rights were at stake.

By grounding the decision in the first amendment and by referring to the government's general right to use its property for its own purposes, the Eighth Circuit's opinion may have serious ramifications for free speech beyond the

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149. The laws governing the military are different from and more restrictive than the laws governing civilians because the purpose of the military is national defense. There is therefore a greater need for control over both the people being trained and the area in which they are trained. *See, e.g.*, Parker v. Levy, 417 U.S. 733, 756 (1974) (upholding military code provisions prohibiting willful disobedience of command and conduct unbecoming an officer; Court reasoned that Congress can legislate with greater flexibility and breadth when enacting military rules because of differences in military and civilian societies); Burns v. Wilson, 346 U.S. 137, 140 (1953) (upholding court martial convictions in face of allegations that military proceeding violated due process rights; Court noted rights of men in military must be conditioned to meet overriding demands of discipline and duty); Orloff v. Willoughby, 345 U.S. 83, 94 (1953) (foreclosing judicial review through habeas corpus proceedings of military assignments of those lawfully inducted into Army; Court argued military constitutes specialized community governed by separate discipline from civilians).

150. In *Greer*, for example, the challenged regulation restricted only speech directed at the enlisted men, and then only while the men were within the confines of the base. *Greer*, 424 U.S. at 832. Significantly, in the prison situation, the Court had invalidated a mail censorship regulation that failed to further any substantial governmental interest and was not narrowly drawn to reach only material that would encourage violence. Procunier v. Martinez, 416 U.S. 396, 415-16 (1974). The Court rejected the argument that the censorship scheme could be justified merely by reference to the legal status of the prisoners. *Id.* at 409. Instead, the Court premised its review of the regulations on the fact that the regulation implicated the first amendment rights of the civilians receiving or sending mail to the prisoners. *Id.* at 408.

limited circumstances of civilian-military interaction. Clearly, if the government may determine that public property can be used only by those sectors of the community that support rather than criticize national policies, the proscription against viewpoint regulation has been destroyed. Maintaining this prohibition is crucial for the preservation of the public's freedom to criticize the government and debate issues of public policy. This freedom, in theory and in fact, is essential to the effective operation of democratic government.

Laura Hedal

STATUTORY COMMENTARY

Retroactive Awards of Attorneys' Fees: Finding a Fair Interpretation of the Equal Access to Justice Act

Joe Jones owns Joe's Pizza Emporium in Smalltown, Iowa. An OSHA inspector notifies Joe that he is being fined $500 for his failure to clear trash from the pizzeria's rear exit. Although Joe, a fastidious restauranteur, is certain that OSHA is referring to the exit of a neighboring pawn shop, OSHA refuses to concede its mistake. Joe's lawyer informs him that contesting the fine could cost thousands of dollars in attorneys' fees, even though OSHA's contention is completely unsupported. Joe, not a wealthy man, reluctantly pays the fine.

Congressional hearings in the late 1970's attracted dozens of businessmen who told stories of serious financial setbacks, including bankruptcy, after successfully contesting unjustified government actions.[1] In 1980 Congress responded to these concerns by passing the Equal Access to Justice Act (EAJA).[2] Under its most significant provisions, the EAJA allows certain prevailing parties to recover their attorneys' fees from the federal government in civil actions and administrative proceedings unless the United States can show that its position was substantially justified.[3]

The EAJA became effective on October 1, 1981.[4] Section 208 of the Act specifically provides for the recovery of attorneys' fees in all cases "pending on, or commenced on or after," that date.[5] Before passage of the EAJA, both the traditional American rule requiring parties to bear their own litigation costs[6] and the federal sovereign immunity doctrine[7] had barred awards of at-

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1. *See infra* notes 59-61 and accompanying text (testimony and comments on high litigation costs faced by individuals and small businessmen contesting unjustified government actions).

2. Pub. L. No. 96-481, tit. II, 94 Stat. 2321, 2325-30 (1980) [hereinafter EAJA] (codified at 5 U.S.C. § 504 (Supp. V 1981), 28 U.S.C. § 2412 (Supp. V 1981)).

3. 5 U.S.C. § 504(a)(1) (Supp. V 1981); 28 U.S.C. § 2412(d)(1)(A) (Supp. V 1981). *See infra* notes 22-31 and accompanying text (methods of recovering attorneys' fees and other expenses in actions against the United States under the EAJA).

4. EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981), 28 U.S.C. § 2412 note (EFFECTIVE DATE OF 1980 AMENDMENT) (Supp. V 1981).

5. *Id.* Section 208 states, "This title and the amendments made by this title shall take effect of [sic] October 1, 1981, and shall apply to any adversary adjudication . . . and any civil action . . . which is pending on, or commenced on or after, such date." *Id.*

6. *See infra* notes 12-13 and accompanying text (American rule barring awards of attorneys' fees to prevailing party subject only to narrow common law exceptions and statutes authorizing courts to award fees).

7. Essentially, the doctrine of sovereign immunity protects the sovereign from suit without its consent. In 1857 Chief Justice Taney wrote in Beers v. Arkansas, 61 U.S. (20 How.) 527 (1857):

> It is an established principle of jurisprudence in all civilized nations that the sovereign cannot be sued in its own courts, or in any other, without its consent and permission; but it may . . . waive this privilege, and permit itself to be made a defendant in a suit. . . . [A]s this permission is altogether voluntary . . . it follows that [the sovereign] may prescribe the terms and conditions on which it consents to be sued, and the manner in which the suit shall be conducted, and may withdraw its consent whenever it may suppose that justice to the public requires it.

torneys' fees against the United States in the absence of explicit statutory authorization.[8] Congress intended the EAJA to provide that specific authorization, thereby both creating an incentive for private litigants to contest unjustified government actions and compensating those who had decided to fight unjustified actions despite the high cost.[9]

Sovereign immunity, however, has retained considerable vitality as a defense against the award of fees incurred before the Act's effective date in cases that were still pending on that date. The government is arguing with some success that section 208 is not sufficiently explicit to permit awards of such pre-Act fees.[10] Thus, under the government's construction of the statute, had the owner of Joe's Pizza Emporium brought suit on December 1, 1978 and obtained a favorable court decision on November 30, 1981, he could collect only two months of his three years of attorneys' fees.

This note demonstrates that, contrary to the government's contention, federal sovereign immunity does not bar recovery of pre-Act attorneys' fees incurred in litigation pending on the EAJA's effective date. First, the note puts the dispute in historical and constitutional perspective. It briefly explains how explicit waivers of federal sovereign immunity must be, how private litigants can recover their attorneys' fees under the EAJA, and why the provision applying the Act to "pending cases" lends itself to conflicting judicial interpretations. The note then proposes that to construe the Act as explicitly waiving sovereign immunity for pre-Act fees in pending cases, two separate but overlapping tests established by the Supreme Court must be satisfied. First, courts must determine whether allowing awards of pre-Act fees incurred in pending cases is a "fair interpretation" of the statute. This determination also requires satisfaction of the second test—whether retroactive application of the Act presents a threat of "manifest injustice." The note establishes that the two tests are met upon examination of the language of the statute, its legislative history and purposes, cost estimates for the Act prepared for Congress, and judicial interpretations of analogous fee-shifting statutes. Finally, in an effort to quell concern over the potentially burdensome result of retroactive application, the

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Id. at 529. *See also* United States v. Lee, 106 U.S. 196, 207 (1882) (although exemption of federal and state governments from defending ordinary actions has been repeatedly asserted in Supreme Court, principle has never been discussed or reasons for it given: exemption always treated as established doctrine).

8. *See infra* notes 15-16 and accompanying text (explicit statutory authorization required to overcome traditional federal sovereign immunity against fee-shifting even under common law exceptions to American rule).

9. *See infra* notes 54-63, 71-78 and accompanying text (discussing Congress' compensation and incentive goals in passing EAJA).

10. Only a handful of federal district courts have confronted the issue of the EAJA's application to pre-Act fees incurred in cases still pending on its effective date. At least one district court has accepted the government's argument that retroactive application of the EAJA is barred by federal sovereign immunity. Allen v. United States, 547 F. Supp. 357, 362 (N.D. Ill. 1982). The *Allen* court held that the Act's statutory language, purpose, and legislative history, in addition to interpretations of analogous statutes, do not support application to pre-Act fees in pending cases. *Id. See infra* notes 79-85, 89, 105, 150-55 and accompanying text (discussing *Allen* court's acceptance of Justice Department's arguments against retroactive application of EAJA). The same court, in another case, has ordered rehearings and withheld its decision on retroactive application of the Act because of the dispute over the EAJA's waiver of sovereign immunity. Commodity Futures Trading Comm'n v. Rosenthal & Co., 537 F. Supp. 1094, 1097 (N.D. Ill. 1982). *See infra* note 21 (discussing conflict in federal district courts over retroactive application of EAJA).

note observes that the EAJA provides its own mechanism for protecting the federal government from unfair fee awards.

I. OVERCOMING THE AMERICAN RULE AND SOVEREIGN IMMUNITY

The American rule for distributing litigation costs and federal sovereign immunity stand as twin barriers to an award of attorneys' fees against the United States.[11] Under the American rule, each litigant is required to bear his own attorneys' fees unless either an applicable statute authorizes a court to award them[12] or the case fits one of two narrow, common law exceptions to the rule developed by the courts in an exercise of their inherent equitable powers.[13] A federal statute applies the American rule, subject to specific exceptions provided for by Congress, to actions brought by or against the United States.[14] Under the doctrine of sovereign immunity, the United States is immune from

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11. *See* Muth v. Marsh, 525 F. Supp. 604, 606 (D.D.C. 1981) (when federal government loses cases, both sovereign immunity and American rule against fee-shifting bar attorneys' fee award).

12. The American rule barring courts from awarding attorneys' fees in the absence of statutory authorization was acknowledged by the Supreme Court as early as 1796. *See* Arcambel v. Wiseman, 3 U.S. (3 Dall.) 306, 306 (1796) (general practice in United States prohibits including attorneys' fees as damages in the absence of statutory authorization). In Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975), the Supreme Court reaffirmed the American rule as embodied in *Arcambel*. *Id.* at 250. *See also* Note, *The Equal Access to Justice Act: How to Recover Attorneys' Fees & Litigation Expenses from the United States Government*, 13 U. TOL. L. REV. 149, 150 (1981) (general rule in United States bars recovery of attorneys' fees by prevailing party in the absence of statutory exception).

Many of the statutes allowing courts to award the attorneys' fees of private litigants rest on the assumption that important public policies embodied in civil rights and other statutes are best enforced by encouraging private litigation. *See Alyeska Pipeline*, 421 U.S. at 263 (statutes authorizing courts to award attorneys' fees reflect Congress' decision to rely heavily on private enforcement to implement public policy).

13. Federal courts have invoked their inherent equitable powers to assess fees under the so-called "bad faith" and "common fund/common benefit" exceptions. Under the bad faith exception, attorneys' fees may be awarded when a court order is willfully disobeyed or when a suit or defense has been maintained "vexatiously, wantonly, or for oppressive reasons." *See Alyeska Pipeline*, 421 U.S. at 258-59 (1975) (courts have retained historic equitable power to assess attorneys' fees for willful disobedience of court order or bad faith); Newman v. Piggie Park Enterprises, Inc., 390 U.S. 400, 402 n.4 (1968) (per curiam) (federal court may award counsel fees to successful plaintiff when defense maintained in bad faith, vexatiously, wantonly, or for oppressive reasons). The common fund/common benefit exception allows courts to award attorneys' fees when a successful party preserves or recovers a fund that confers a benefit on others. The fee award is made out of the "common fund" created by the party's action. *See, e.g., Alyeska Pipeline*, 421 U.S. at 257-58 (1975) (courts have retained historic equitable power to permit trustee of fund or property, or party preserving or recovering fund for benefit of others, to recover attorneys' fees from fund or property itself or directly from parties benefited); Rich v. Industrial Lumber Co., 417 U.S. 116, 130 (1974) (common fund exception allows courts to award attorneys' fees when successful litigant confers substantial benefit on particular class and fee-shifting spreads cost proportionately among members of benefited class); Brennan v. United Steelworkers of America AFL-CIO-CLC, 554 F.2d 586, 604-05 (3rd Cir. 1977) (common benefit exception applies when private action confers benefit on larger identifiable group and fee award shifts litigation costs to that group), *cert. denied*, 435 U.S. 977 (1978).

The Supreme Court in *Alyeska Pipeline* prohibited further judicial expansion of the traditional common law exceptions of bad faith and common fund/common benefit. *Alyeska Pipeline*, 421 U.S. at 269-71. The Court rejected the lower court's recognition of a new "private attorneys general exception" authorizing the federal judiciary to award fees "whenever the courts deem the public policy furthered by a particular statute important enough to warrant the award." *Id.* at 241, 246.

14. An Act to Provide for Judgments for Costs Against the United States, Pub. L. No. 89-507, 80 Stat. 308 (1966) (codified in relevant part at 28 U.S.C. § 2412(a) (Supp. V 1981)). "Except as otherwise specifically provided by statute," section 2412(a) permits courts to award costs, "but not including the fees and expenses of attorneys," to any prevailing party in any civil action brought by or against the United States. 28 U.S.C. § 2412(a) (Supp. V 1981). Although the EAJA significantly amended section 2412, subsection (a) remained essentially unchanged.

suit unless it consents to be sued.[15] Any waiver of federal sovereign immunity cannot be implied but must be explicit.[16] These long-established principles of sovereign immunity protect the United States from the common law exceptions to the American rule and from statutory exceptions that do not expressly include the federal government within their ambit.[17]

Although section 208 of the EAJA clearly waives the American rule and federal sovereign immunity for attorneys' fees incurred after October 1, 1981,[18] the Act's application to pre-Act fees incurred in cases pending on its effective date is not apparent[19] from the language of the statute.[20] The government has taken advantage of the EAJA's apparent ambiguity to argue that Congress did not explicitly waive federal sovereign immunity against the award of pre-Act fees.[21]

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15. Affiliated Ute Citizens v. United States, 406 U.S. 128, 141 (1972); *see* United States v. Testan, 424 U.S. 392, 399-400 (1976) (without Congress' consent to cause of action against United States for wages lost from improper job classifications of federal employees, court cannot award damages against federal government).

16. *See* United States v. Testan, 424 U.S. 392, 399-400 (1976) (waiver of federal sovereign immunity must be expressed unequivocally).

17. *See* Pealo v. Farmers Home Admin. of United States Dep't of Agriculture, 562 F.2d 744, 748 (D.C. Cir. 1977) (sovereign immunity renders common benefit exception to American rule inapplicable when federal government involved; only specific statutory authority allows fee awards against government); Rhode Island Comm. on Energy v. General Services Admin., 561 F.2d 397, 405 (1st Cir. 1977) (sovereign immunity renders bad faith exception to American rule inapplicable when federal government involved; only exceptions specifically provided by statute subject government to liability for attorneys' fees).

18. The EAJA specifically applies to fees incurred in civil actions or adversary adjudications "commenced on or after" the effective date of the Act. EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981). *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1157 (N.D. Ill. 1982) (government does not deny EAJA explicitly waives sovereign immunity for recovery of fees incurred after October 1, 1981); OFFICE OF LEGAL POLICY, U.S. DEP'T OF JUSTICE, AWARD OF ATTORNEY FEES AND OTHER EXPENSES IN JUDICIAL PROCEEDINGS UNDER THE EQUAL ACCESS TO JUSTICE ACT 51 (undated) ("no doubt" that EAJA contains explicit waiver of sovereign immunity for recovery of attorneys' fees incurred after October 1, 1981) [hereinafter AWARD OF ATTORNEY FEES UNDER EAJA].

19. *But see infra* note 21 and accompanying text (some courts interpreting EAJA hold that plain meaning of "pending" is to allow awards of pre-Act fees in cases unresolved on Act's effective date).

20. *See* EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981), 28 U.S.C. § 2412 note (EFFECTIVE DATE OF 1980 AMENDMENT) (Supp. V 1981). That section provides:

> This title and the amendments made by this title shall take effect of [sic] October 1, 1981, and shall apply to any adversary adjudication, as defined in section 504(b)(1)(C) of title 5, United States Code, and any civil action or adversary adjudication described in section 2412 of title 28, United States Code, which is pending on, or commenced on or after, such date.

EAJA § 208.

21. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1157 (N.D. Ill. 1982) (government acknowledges Act clearly covers cases pending October 1, 1981, but argues EAJA applies only to portion of legal work done after that date); Allen v. United States, 547 F. Supp. 357, 358 (N.D. Ill. 1982) (government argues sovereign immunity precludes award of attorneys' fees for work done before EAJA's effective date); Nunes-Correia v. Haig, 543 F. Supp. 812, 814 (D.D.C. 1982) (United States asserts that because EAJA does not expressly and unequivocally waive sovereign immunity retroactively, policy against implied waivers of sovereign immunity precludes award of fees incurred prior to Act's effective date); Wolverton v. Schweiker, 533 F. Supp. 420, 423 (D. Idaho 1982) (government concludes no fee award can be based on implied waiver of sovereign immunity and EAJA therefore cannot authorize fees incurred prior to Act's effective date); AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 51 (although Act explicitly waives sovereign immunity for recovery of attorney fees after effective date, failure to explicitly waive immunity for pre-Act fees precludes recovery).

A number of courts have awarded fees in pending cases for services rendered before the EAJA's effective date. Many of these courts have failed to address whether the EAJA waived federal sovereign immunity for those pre-Act fees and have simply interpreted the word "pending" to require retroactive

application of the Act. *See, e.g.,* Ocasio v. Schweiker, 540 F. Supp. 1320, 1323 n.15 (S.D.N.Y. 1982) (referring to Act's language that specifically allows recovery of fees as long as matter was "pending" on or commenced after EAJA's effective date, court dismissed government claim that plaintiff's attorneys entitled only to fees incurred after effective date); Costantino v. United States, 536 F. Supp. 60, 61, 64 (E.D. Pa. 1981) (contrary to government's argument, retroactivity not an issue because Act allows awards of fees incurred in all pending cases); Wolverton v. Schweiker, 533 F. Supp. 420, 423 (D. Idaho 1982) (plain meaning of EAJA is contrary to government's argument that Act applies only to expenses incurred after effective date); *cf.* Muth v. Marsh, 525 F. Supp. 604, 609 (D.D.C. 1981) (court concluded that action was obviously pending on Act's effective date; therefore, plaintiff may apply for legal fees performed in connection with action if he prevails on claim of illegal discrimination).

Courts actually confronting the issue of federal sovereign immunity have reached inconsistent results. A slight majority favors a waiver of sovereign immunity for *all* fees incurred in pending litigation. Generally, these courts rely on the language of the statute, existence of legislative purposes that would be frustrated by denying pre-Act fees, and the substantial precedent supporting retroactive application of other fee-shifting statutes. *See, e.g.,* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1161 (N.D. Ill. 1982) (plain language and history of statute support holding that EAJA waives sovereign immunity for pre-Act fees in pending cases); Underwood v. Pierce, 547 F. Supp. 256, 260-61, 261 n.7 (C.D. Ca. 1982) (interpretation that EAJA waived federal sovereign immunity for pre-Act fees conforms with uniform judicial interpretation of other attorneys' fees acts that allowed fees for work performed in pending cases prior to acts' effective dates); Nunes-Correia v. Haig, 543 F. Supp. 812, 814-16 (D.D.C. 1982) (EAJA's language, purposes, cost estimates, and judicial precedent support application of Act to all fees incurred in pending cases); Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 n.5 (D.D.C. 1982) (EAJA explicitly applies to cases pending on October 1, 1981, and nothing in legislative history suggests that EAJA applies in such cases only to fees incurred after that date).

Courts limiting the waiver of sovereign immunity to post-Act fees reason that the EAJA's application to "pending" cases is ambiguous, that the single purpose expressed in the statute's language is not furthered by allowing awards of pre-Act fees, and that cost estimates for the EAJA prepared for Congress did not take pre-Act fees into account. Further, one court has analogized to a recent United States Court of Claims decision that prohibited retroactive application of another statute because allowing awards of pre-Act interest would impose a large liability on the federal government. *See* Allen v. United States, 547 F. Supp. 357, 361-62 (N.D. Ill. 1982) (EAJA's waiver of sovereign immunity insufficiently explicit in light of both ambiguous statutory language and failure, as in *Brookfield Construction*, 671 F.2d 159 (Ct. Cl. 1981), of cost estimates to acknowledge significant costs federal government would incur by allowing awards of pre-Act fees; precedents supporting retroactive application of fee-shifting statutes irrelevant because federal sovereign immunity not involved); *see also* Commodity Futures Trading Comm'n v. Rosenthal & Co., 537 F. Supp. 1094, 1096-97, 1097 n.3 (N.D. Ill. 1982) (dictum) (judgment reserved on retroactivity issue until further briefings completed because EAJA's "pending" provision subject to "rational reading" that only post-Act fees allowed, cost estimates suggest retroactive application not intended, and sovereign immunity requires "unequivocal" waiver).

The United States Court of Appeals for the Fifth Circuit stopped short of awarding pre-Act fees in a case pending on the EAJA's effective date in Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 679 F.2d 64 (5th Cir. 1982). Prior to the EAJA's effective date, the Fifth Circuit had denied the KKK an award of attorneys' fees against the Department of Health, Education, and Welfare under the Civil Rights Attorney's Fees Awards Act (CRAFAA), 42 U.S.C. § 1988 (Supp. IV 1980). Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 643 F.2d 1034, 1039 (5th Cir. 1981) (CRAFAA did not waive federal sovereign immunity against attorneys' fees), *vacated and remanded*, 454 U.S. 1075 (1982). While the petition for writ of certiorari was pending before the Supreme Court, the EAJA became effective, and the Supreme Court remanded the case for consideration in light of the Act. Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 454 U.S. 1075, 1075 (1982). On remand, the Fifth Circuit failed to discuss federal sovereign immunity, holding only that fees incurred in the litigation could be awarded in cases pending on the EAJA's effective date, even if the only issue then pending was a motion for attorneys' fees. Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 679 F.2d 64, 67-68 (5th Cir. 1982). The Fifth Circuit remanded the case, however, instructing the district court to determine whether the KKK meets the EAJA's financial limitations and whether the government's position was substantially justified. *Id.* at 68-69. One federal district court, reviewing the history of *Baton Rouge Parish School Board*, noted that neither the Supreme Court nor the Fifth Circuit expressed any reservations about applying the EAJA retroactively. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1158 & n.2 (N.D. Ill. 1982) (neither Supreme Court nor Fifth Circuit expressed concern about scope of EAJA's waiver of federal sovereign immunity, despite fact that all legal work on case was completed before EAJA's effective date and only issue still pending was motion for attorneys' fees).

II. STATUTORY CONTEXT OF THE RETROACTIVITY DISPUTE

Under the EAJA, the prevailing party[22] in actions brought by or against the United States[23] may recover attorneys' fees and other expenses[24] in two instances. First, the Act gives federal courts discretionary authority to award fees against the United States in civil actions to the same extent that federal courts award fees between private parties.[25] In other words, the EAJA extinguishes the immunity from the common law exceptions to the American rule previously enjoyed by the federal government.[26] Second, in a more innovative provision, the Act requires that a prevailing party's fees be awarded in judicial proceedings[27] and adversary adjudications[28] unless the United States can show

22. Although "prevailing party" is not defined in the Act itself, the EAJA's legislative history indicates that the term should be interpreted consistently with the law that has developed under other fee-shifting statutes. *See infra* note 160 (legislative history demonstrates congressional intent that courts look to interpretation of other fee-shifting statutes in construing EAJA's terms). Parties may recover under the EAJA, therefore, even if they did not receive a favorable final judgment after a full trial on the merits. H.R. REP. NO. 1434, 96th Cong., 2d Sess. 15, 21-22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 5003, 5010-11 (Conference Report) (for example, party may be deemed "prevailing" if a favorable settlement obtained, if the plaintiff sought voluntary dismissal of groundless complaint, or even if party did not ultimately win favorable judgment on all issues); H.R. REP. NO. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990 (same); S. REP. NO. 253, 96th Cong., 1st Sess. 7 (1979) (same). The conference report cited above relied on, among other cases, Bradley v. Richmond School Bd., 416 U.S. 696 (1974), a Supreme Court decision allowing retroactive application of the fee-shifting provision of a federal statute against a local school board. *Id.* at 709, 724. H.R. REP. NO. 1434, 96th Cong., 2d Sess. 22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 5011 (Conference Report) (citing *Bradley*). *See infra* notes 116-45 and accompanying text (discussing *Bradley*).

23. Under the EAJA, "United States" includes any agency and any official of the United States acting in his or her official capacity. 28 U.S.C. § 2412(d)(2)(C) (Supp. V 1981).

24. In addition to attorneys' fees, "fees and other expenses" as defined in the Act include "reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project" that the court or agency finds "necessary for the preparation of the party's case." 5 U.S.C. § 504(b)(1)(A) (Supp. V 1981); 28 U.S.C. § 2412(d)(2)(A) (Supp. V 1981). The statute limits compensation of expert witnesses to the highest rate paid by the United States for expert witnesses, and places a limit of $75 per hour on awards of attorneys' fees unless the court determines that an increase in the cost of living or some other special factor justifies a higher fee. 28 U.S.C. § 2412(d)(2)(A)(i)-(ii) (Supp. V 1981); 5 U.S.C. § 504(b)(1)(A)(i)-(ii) (Supp. V 1981).

25. 28 U.S.C. § 2412(b) (Supp. V 1981). The section provides:

> Unless expressly prohibited by statute, a court may award reasonable fees and expenses of attorneys . . . to the prevailing party in any civil action brought by or against the United States . . . . The United States shall be liable for such fees and expenses to the same extent that any other party would be liable under the common law or under the terms of any statute which specifically provides for such an award.

Id.

26. *Id.*

27. 28 U.S.C. § 2412(d)(1)(A). The section provides:

> Except as otherwise specifically provided by statute, a court shall award to a prevailing party other than the United States fees and other expenses . . . incurred by that party in any civil action (other than cases sounding in tort) brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

Id.

As indicated by the "[e]xcept as otherwise specifically provided by statute" language, Congress intended that section 2412(d)(1)(A) not affect other statutes authorizing fee-shifting against the federal government. For example, recovery of attorneys' fees under the Freedom of Information Act, 5 U.S.C. § 552(a)(4)(E) (1976), would still be governed by the terms of that statute and the case law developed under it. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 18, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4997. The Act itself also specifies that nothing in section 2412(d) "alters, modifies, repeals, invali-

its position was "substantially justified" or that "special circumstances" exist that would make an award unjust.[29] A party seeking to recover attorneys' fees under the substantial-justification provision, however, must also meet the Act's size and net worth limitations.[30] A sunset provision terminates the substantial-justification method for recovering attorneys' fees in three years to allow Congress to examine the Act's costs and impact on the federal bureaucracy.[31]

By waiving the federal government's sovereign immunity from fee-shifting under the common law exceptions to the American rule, Congress enacted the principle that the United States should, at a minimum, be held to the same standards in litigating as private parties.[32] Congress expressly found no justification for exempting the federal government from the common law exceptions to the American rule.[33] Although Congress' purposes for permitting courts to award fees when the government's action was not "substantially justified" are somewhat more complex,[34] the rationale for holding the United States to a stricter standard of conduct was based generally on the government's superior

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dates, or supersedes any other provision of Federal law which authorizes an award of such fees and other expenses" to a prevailing party in a civil action against the United States. EAJA § 206, 28 U.S.C. § 2412 note (SAVINGS PROVISIONS) (Supp. V 1981).

28. 5 U.S.C. § 504(b)(1)(C) (Supp. V 1981). "Adversary adjudications" are adjudications as defined in 5 U.S.C. § 554 (Supp. V 1981) in which the position of the United States is represented by counsel or otherwise. 5 U.S.C. § 504(b)(1)(C) (Supp. V 1981). Adjudication for the purpose of establishing or fixing rates or granting or renewing licenses are excluded from coverage by the Act. *Id.*

29. 5 U.S.C. § 504(a)(1) (Supp. V 1981); 28 U.S.C. § 2412(d)(1)(A) (Supp. V 1981).

The test for determining whether the government action was substantially justified is "essentially one of reasonableness." H.R. REP. NO. 1434, 96th Cong., 2d Sess. 15, 22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 5003, 5011 (Conference Report) (when government can show case had reasonable basis in law and fact, no award should be made under Act); H.R. REP. NO. 1418, 96th Cong., 2d Sess. 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4989 (same); S. REP. NO. 253, 96th Cong., 1st Sess. 6 (1979) (same). The Act's legislative history provides examples of certain types of case dispositions that may indicate a lack of substantial justification. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4989-90 (judgment on pleadings, directed verdict, or dismissal of prior suit on same claim indicate lack of substantial justification of government's position); S. REP. NO. 253, 96th Cong., 1st Sess. 6-7 (1979) (same). A defeat of the government alone, however, would not create a presumption that the government's position was not substantially justified. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990; S. REP. NO. 253, 96th Cong., 1st Sess. 7 (1979).

30. Because the EAJA is designed primarily to benefit small businesses and groups and individuals of average means, *see infra* notes 54-61 (discussing this objective of Act), the Act limits eligibility to: individuals whose net worth did not exceed $1 million when the action was filed; sole owners of unincorporated businesses, or partnerships, corporations, associations, or organizations whose net worth did not exceed $5 million when the action was filed; sole owners of unincorporated businesses, or partnerships, corporations, associations, or organizations with not more than 500 employees at the time the action was filed; or certain tax-exempt and agricultural cooperative associations, regardless of their net worth. 5 U.S.C. § 504(b)(1)(B) (Supp. V 1981); 28 U.S.C. § 2412(d)(2)(B) (Supp. V 1981).

31. Both 5 U.S.C. § 504(a) and 28 U.S.C. § 2412(d) are repealed effective October 1, 1984. EAJA § 204(a), 5 U.S.C. § 504 (Supp. V 1981); EAJA § 203 (a)(1), 28 U.S.C. § 2412 (Supp. V 1981). Actions commenced before the date of repeal of either subsection continue to be covered by the provisions. *Id.*

32. *See* 126 CONG. REC. S13,874-75 (daily ed. Sept. 30, 1980) (statement of Sen. DeConcini) (conference report's conclusion that United States should be held to minimum standards required of private parties reflects "strong movement" toward placing federal government and civil litigants on "completely equal footing"); H.R. REP. NO. 1418, 96th Cong., 2d Sess. 9, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4987 (committee finds "no justification" for exempting United States from common law and statutory exceptions to American Rule); S. REP. NO. 253, 96th Cong., 1st Sess. 19 (1979) (same).

33. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 9, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4987.

34. *See infra* notes 51-78 and accompanying text (discussing three purposes reflected in EAJA's legislative history).

resources and expertise in litigation against private parties.[35]

The interpretation of section 208 of the Act has engendered the most controversy. By specifying that the EAJA applies to adversary adjudications and civil actions "pending on, or commenced on or after" October 1, 1981,[36] Congress intended section 208 to clarify the Act's application to actions initiated before its effective date.[37] Although the statute does not define when a case is deemed "pending," courts and commentators unanimously agree that a case is still pending as long as the time to file an appeal has not expired.[38] The dispute over section 208 arises instead from Congress' failure to define precisely *what part* of a pending case the EAJA applies to.[39]

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35. *See, e.g.,* EAJA § 202(b), 5 U.S.C. § 504 note (CONGRESSIONAL FINDINGS AND PURPOSES) (Supp. V 1981) (Congress finds greater resources and expertise of United States justify holding federal government to stricter standard in litigation than standard governing award against private litigant); 125 CONG. REC. 1437 (1979) (statement of Sen. Domenici) (bill seeks to overcome inability of many Americans to combat vast resources of government in administrative adjudications); H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 7 (1980) (because American rule requiring each party to bear own litigation costs makes sense only when each party is equally affected by costs of litigation, rule is inappropriate in actions involving federal government and individuals or small businessmen); S. REP. NO. 253, 96th Cong., 1st Sess. 1 (1979) (economic deterrents to contesting government action magnified by disparity between resources and expertise of individuals and those of their government); *id.* at 5 (small businesses often targets of agency action because they lack resources to fully litigate issues).

36. EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981), 28 U.S.C. § 2412 note (EFFECTIVE DATE OF 1980 AMENDMENT) (Supp. V 1981). The effective date of the Act was delayed one year from the date of enactment for two reasons. First, delaying the effective date until the following fiscal year removed consideration of the bill from the jurisdiction of the House Budget Committee. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 12, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4991. Second, delaying the effective date placated opponents of the bill who wished to set different standards for recovery in certain types of cases. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 12, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4991 (delay will allow Congress time to enact separate bill setting different standard for awards in tax cases before EAJA goes into effect); 126 CONG. REC. H10,224 (daily ed. October 1, 1980) (statements of Reps. Smith, McDade) (delay will allow bill's opponents one year to enact separate standards for recovery by litigants in social security cases).

37. The bill's provision for its application to pending cases was added by the Senate Judiciary Committee. *Compare* 125 CONG. REC. 1439-40 (1979) (text of S. 265, the "Equal Access to Justice Act," which is referred to Judiciary Committee) *with* S. REP. NO. 253, 96th Cong., 1st Sess. 23 (Judiciary Committee Report on S. 265) (section 7 makes Act applicable to "pending cases"). *See also* 125 CONG. REC. 21,445-47 (1979) (text of S. 265 as amended and passed on floor of Senate on July 31; section 7(a), other parts of which were amended on the floor, *see* 125 CONG. REC. 21,440-41 (1979) (proposal by Senator Baucus of and passage of amendment No. 481), applies Act to "any adjudication or civil action which is pending on the date of enactment of this Act, or which is commenced on or after the date of enactment of this Act"). The provision was apparently designed to remedy confusion over the EAJA's application to pending cases. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 19, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4998-99 (provision setting effective date clarifies EAJA's application to adversary adjudications and civil actions pending on or commenced on or after such date).

38. *See, e.g.,* Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 679 F.2d 64, 67 (5th Cir. 1982) (absent legislative history to contrary, action is pending as long as party's right to appeal neither exhausted nor expired); Berman v. Schweiker, 531 F. Supp. 1149, 1151 (N.D. Ill. 1982) (case pending as long as losing party's right to appeal not yet exhausted or expired); AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 48 ("appears to be no doubt that the Act applies to cases in all stages of litigation"; case ceases to be pending when all legal appeals are exhausted or time to appeal has run).

Indeed, a case is deemed pending even if the only matter still before a court is a motion for attorney's fees. *See, e.g.,* Bradley v. Richmond School Bd., 416 U.S. 696, 710, 724 (1974) (application of fee-shifting provision proper when only issue pending resolution on provision's effective date was propriety of fee award); Knights of Ku Klux Klan v. East Baton Rouge Parish School Bd., 679 F.2d 64, 68 (5th Cir. 1982) (case still pending even when only matter before court is motion for attorneys' fees); Buckton v. National College Athletic Ass'n, 436 F. Supp. 1258, 1262 (D. Mass. 1977) (same).

39. The legislative history reveals virtually no consideration of which part of a pending case the Act was supposed to apply to. Professor Joseph Goldberg of the University of New Mexico Law School made the only explicit reference to the issue during testimony at a Senate hearing in late April 1979.

III. RETROACTIVE APPLICATION OF THE EAJA IS CONSISTENT WITH PREVAILING PRINCIPLES OF SOVEREIGN IMMUNITY

The Supreme Court has fashioned two separate but overlapping tests that must be considered in determining whether fees incurred before the Act's effective date can be awarded in cases deemed pending on that date. The first was established by the Court in *United States v. Testan*[40] to ascertain whether a statute creates a right to obtain money damages from the federal government. In *Testan* the Court held that sovereign immunity has been waived if a federal statute can be "fairly . . . interpreted as mandating compensation by the Federal Government for the damage sustained."[41] In the context of a claim for pre-Act attorneys' fees in cases pending on the EAJA's effective date, the issue becomes whether a waiver by the EAJA of sovereign immunity for pre-Act fees is a fair interpretation of section 208 and its legislative history.[42] Several related indicia—the statute's language, its legislative history, and judicial interpretations of similar fee-shifting statutes—demonstrate that retroactive application of the EAJA is a fair reading of the congressional mandate.[43] Under the second test, the Supreme Court has held that a new law may be applied retro-

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He noted that the "considerable controversy" over retroactive application of the Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, 90 Stat. 2641 (1976) (current version at 42 U.S.C. § 1988 (Supp. IV 1980)), had been resolved by a reference to the issue in the committee report on the bill and warned the panel that Congress ought to address the EAJA's application to pending cases. *Hearings Before Subcomm. on Improvement in Judicial Machinery of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 99-100 (1979). Although no specific response was made to Professor Goldberg's remarks on retroactivity, the amendment to the Act specifying that it applied to "cases pending on the date of enactment" was passed just three months later. 125 CONG. REC. 21,445 (1979).

40. 424 U.S. 392 (1976).

41. *Id.* at 400 (quoting Eastport Steamship Corp. v. United States, 372 F.2d 1002, 1009 (Ct. Cl. 1967)). The *Testan* Court rejected a claim that either the Classification Chapter of Title 5, 5 U.S.C. §§ 5101-5115 (1976 & Supp. V 1981) (current version), or the Back Pay Act, 5 U.S.C. § 5596 (1976 & Supp. V 1981) (current version), entitled government employees to back pay for the period of their allegedly wrongful classification. *Testan*, 424 U.S. at 398-407. The Classification Act, the Court noted, provided a variety of means for administrative and judicial relief for a party wrongfully classified, but carried no indication in its language or legislative history that Congress intended to change the established rule allowing federal employees to claim the pay and benefits of a position only after having been duly appointed. *Id.* at 402-03. The Back Pay Act, the Court determined, clearly indicated Congress' intent to grant a monetary cause of action against the United States only to employees wrongfully reduced in grade or suspended from their positions. *Id.* at 405. The plaintiffs in *Testan* alleged that their duties entitled them to a higher job classification, not that they had been wrongfully demoted or suspended. *Id.* at 394. After analyzing the statutory language, legislative history, and case law under similar statutes, the Court held that neither the Classification Act nor the Back Pay Act could be fairly interpreted to authorize compensation by the United States for the difference in pay between the employees' present classification and the one to which they were allegedly entitled. *Id.* at 398-407.

42. *Cf.* NAACP v. Civiletti, 609 F.2d 514, 521-22 (D.C. Cir. 1979) (Wright, C.J., dissenting) (under *Testan*, application of Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, 90 Stat. 2641 (1976) (current version at 42 U.S.C. § 1988 (Supp. IV 1980)), against federal government depends on whether Act can fairly be interpreted as mandating payment of attorney's fees by the United States), *cert. denied*, 447 U.S. 922 (1980).

43. *Cf.* NAACP v. Civiletti, 609 F.2d 514, 516-20 (D.C. Cir. 1979) (Civil Rights Attorney's Fees Awards Act of 1976 does not authorize fee-shifting against United States because phrase applying Act to "any action" and oblique reference to federal liability in legislative history insufficient to authorize awards against United States; Congress used and courts required clear and unequivocal language in other fee-shifting statutes to waive federal sovereign immunity), *cert. denied*, 447 U.S. 922 (1980); *id.* at 522-30 (Wright, C.J., dissenting) (Civil Rights Attorney's Fees Awards Act of 1976 authorizes fee-shifting against United States because fee awards crucial to carry out Congress' intent to encourage enforcement of civil rights statutes, statute's broad language authorizes broad interpretation, federal liability under Act consistent with interpretation of fee-shifting provision of another act, and legislative history supports waiver of federal sovereign immunity).

actively only if such application presents no threat of "manifest injustice."[44] These two tests are necessarily interrelated, for a determination that applying the EAJA retroactively would present no threat of manifest injustice supports a conclusion that application of the EAJA to fees incurred prior to its effective date is a fair interpretation of the Act.

A. THE EAJA'S LANGUAGE SUPPORTS RETROACTIVE APPLICATION

Read in a vacuum, section 208 of the Act does not inescapably lead to the conclusion that awards of pre-Act fees are authorized by the EAJA. It is precisely the absence in the statute of unequivocal language concerning the Act's retroactive application that has prompted disagreement among courts interpreting the EAJA. Although most courts interpreting the EAJA have examined legislative history and case law to determine whether Congress intended the Act to apply retroactively,[45] some courts have awarded pre-Act fees incurred in pending cases by interpreting the plain meaning of "pending" to require retroactive application of the Act.[46]

Although this plain meaning analysis is overly simple, the EAJA's explicit reference to pending cases supports the argument that retroactive application is a logical reading of the Act. Courts ruling on the application of other fee-shifting provisions that specifically refer to pending cases have not limited their application to fees incurred on or after the statutes' effective dates but have awarded all fees incurred by eligible litigants.[47] Because Congress intended that the EAJA's terms be applied consistently with prior case law dealing with the award of attorneys' fees,[48] the use of the term "pending" in section 208 suggests congessional support for retroactivity.[49]

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44. *See* Bradley v. Richmond School Bd., 416 U.S. 696, 711 (1974) (court should apply law in effect at time decision is rendered unless doing so would result in "manifest injustice" or there is statutory direction or legislative history to the contrary).

45. *See, e.g.,* Allen v. United States, 547 F. Supp. 357, 361 (N.D. Ill. 1982) (court examined statutory language and prior case law authorizing retroactive awards of attorneys' fees under other statutes in holding that EAJA does not authorize award of fees incurred prior to its effective date); Nunes-Correia v. Haig, 543 F. Supp. 812, 815-16 (D.D.C. 1982) (Congressional Budget Office cost estimates and absence of manifest injustice in applying EAJA retroactively evince conclusion that EAJA authorizes fees for work performed before October 1, 1981, in cases pending on that date); Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 (D.D.C. 1982) (nothing in EAJA's legislative history suggests intent to bifurcate cases on Act's effective date).

46. *See supra* note 21 (discussing cases interpreting plain meaning of "pending").

47. *See infra* notes 161-62 and accompanying text (when new fee-shifting statute applied to pending cases, courts uniformly allow recovery of all fees incurred).

48. *See infra* notes 159-60 and accompanying text (Congress intended EAJA's terms be construed consistently with existing body of law on award of attorneys' fees).

49. *See* Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 (D.D.C. 1982) (nothing in EAJA's legislative history suggests Act should be interpreted to apply only to part of case pending on October 1, 1981 that occurs on or after that date); Wolverton v. Schweiker, 533 F. Supp. 420, 423 (D. Idaho 1982) (if Congress had intended to limit EAJA's applicability, it could have restricted potential cost and fee awards to those incurred after Act's effective date).

Moreover, as the United States District Court for the District of Columbia observed in Nunes-Correia v. Haig, 543 F. Supp. 812 (D.D.C. 1982), the EAJA's explicit reference to pending cases is significant because other courts have construed fee-shifting statutes retroactively even when those statutes were completely silent on their application to pending cases. *Id.* at 816. Thus, the presence of the term "pending" in the EAJA lends more credence to applying the Act retroactively. *Id.*

B. CONGRESS' GOALS IN PASSING THE EAJA SUPPORT RETROACTIVE APPLICATION

The policies advanced by Congress' enactment of the EAJA support retroactive application, and courts should favor an interpretation of the Act that is consistent with Congress' purposes.[50] The EAJA's language and legislative history express three closely related goals in allowing recovery of litigation costs: to compensate citizens who challenge rather than acquiesce in unreasonable government action;[51] to deter government overregulation and unreasonable exercises of government authority;[52] and to create incentives for citizens to contest such unreasonable government action.[53] Denying successful litigants their pre-October 1981 legal fees frustrates the goal of compensating victims of unreasonable government actions. Furthermore, denying retroactive application of the Act interferes with its deterrence function by reducing awards against federal agencies guilty of unjustified regulation. And the goal of creating incentives for private litigation against the government is advanced by applying the Act retroactively to the extent that some individuals who filed suit between the date of the EAJA's passage and the date it became effective did so in expectation of the Act's benefits.

One of the major objectives of the EAJA was to recompense small businessmen for the high litigation costs incurred in challenging unjustified government actions.[54] By requiring offending agencies to pay reasonable litigation costs, the EAJA would "make whole" victims of unreasonable agency actions who prevail against the government,[55] thereby spreading the cost of challeng-

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50. A court's responsibility when interpreting a statute has been expressed as the "duty . . . to favor an interpretation which would render the statutory design effective in terms of the policies behind its enactment and to avoid an interpretation which would make such policies more difficult of fulfillment, particularly where . . . that interpretation is consistent with the plain language of the statute." National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672, 689 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974).

51. *See infra* notes 54-63 and accompanying text (legislative history regarding Act's compensation function).

52. *See infra* notes 64-70 and accompanying text (legislative history regarding Act's function as deterrent to overregulation).

53. *See infra* notes 71-72 and accompanying text (legislative history regarding Act's intended incentives for private litigants to contest unjustified government actions).

54. In the floor debate on the day the House passed the EAJA, Representative Neal Smith, cosponsor of the Act, emphasized the extreme importance of attorney fee reimbursement to the small business community:

> We had people come before the committee who went bankrupt trying to defend themselves against an action that was subsequently found and adjudicated to be without substantial justification on the part of Government attorneys. In that kind of case . . . the adjudicating officer or the judge ought to be able to say, "Hey, look, this person should not go bankrupt because a civil action was brought against him and it should not have been brought." We ought to be able to pay their attorneys' fees.

126 CONG. REC. H10,219 (daily ed. Oct. 1, 1980). *See also* H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 8 (1980) (reporting testimony from witness who spent $40,000 in attorneys' fees over four years defending unreasonable government suit); *id.* at 11 (reporting testimony from small business owners who elected to fight government action despite high litigation costs and ultimately won but faced bankruptcy because of costs involved); 126 CONG. REC. H588 (daily ed. Feb. 5, 1980) (statement of Rep. McDade) (anecdote about businessman who spent $15,000 to prove fine imposed by Department of Labor was unjustified).

55. *See, e.g., Award of Attorneys' Fees Against the Federal Government: Hearings on S. 265 Before the Subcomm. on Courts, Civil Liberties and the Administration of Justice of House Comm. on the Judiciary,*

ing regulations.[56] Congress believed that the private citizens and small businesses that challenge unreasonable actions by the government serve "a public policy and a public purpose" both by correcting agency errors and by protecting others from the expense of contesting unjustified government actions.[57] Senator DeConcini, one of the bill's sponsors, observed that the EAJA recognizes that the expense of correcting government errors should not rest wholly on the party whose willingness to litigate helped to define the limits of federal authority.[58]

Prior to the Act's passage, small businessmen deluged Congress with testimony showing the financial difficulties and even bankruptcy many had faced because of the legal costs incurred in vindicating their positions.[59] One witness, for example, testified that he had spent $40,000 in attorneys' fees over a four-year period defending a government suit that the court eventually found to have been groundless.[60] Prior to the EAJA's enactment, private litigants were often forced to choose between paying a relatively small fine or incurring legal costs many times the size of the fine, regardless of the strength of the government's position.[61] Without retroactive application, however, many parties who brought suit months or years before the EAJA's effective date will bear the

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96th Cong., 2d Sess. 24 (1980) (statement of Sen. DeConcini) (purposes of EAJA include "making whole those who have been the victims of unreasonable government action") [hereinafter *House Judiciary Hearings*]; H.R. REP. NO. 1005, pt. 1, 96th Cong., 2d Sess. 5 (1980) (purpose of EAJA is to allow individuals and small businessmen to be reimbursed for expenses if successful against unjustified government actions); 126 CONG. REC. H10,013 (daily ed. Sept. 30, 1980) (statement of Rep. Boner) (awarding reasonable attorneys' fees will give small business community "the necessary relief in their war against Government overregulation"); 125 CONG. REC. 21,435 (1979) (statement of Sen. DeConcini) (one purpose of EAJA is to compensate people who have been victims of arbitrary government actions); Statement on Signing [EAJA] Into Law, 16 WEEKLY COMP. PRES. DOC. 2381, 2381 (Oct. 27, 1980) (EAJA will provide financial relief to small businesses that prevail in litigation).

56. The notion of spreading the cost of challenging unfair government regulations was considered closely related to the goal of compensating victims of unreasonable government actions. *See, e.g., Judicial Access/Court Costs: Hearings Before the Subcomm. on SBA and SBIC Authority and General Small Business Problems of the House Comm. on Small Business*, 96th Cong., 2d Sess. 170 (1980) (statement of Sen. DeConcini) (private citizens and small businessmen who challenge unreasonable government actions "are serving a public policy and a public purpose, and it is unfair to ask them to finance through their tax dollars unreasonable government action and then to also bear the costs of vindicating those rights") [hereinafter *House Small Business Hearings*]; S. REP. NO. 253, 96th Cong., 1st Sess. 6 (1979) (EAJA "recognizes that the expense of correcting error on the part of the Government should not rest wholly on the party whose willingness to litigate or adjudicate has helped to define the limits of Federal authority"); 126 CONG. REC. S13,690 (daily ed. Sept. 26, 1980) (statement of Sen. DeConcini) (unfair for private citizens and small businessmen first to finance unreasonable government actions through their tax dollars and then to bear costs of vindicating their rights against those actions).

57. *House Small Business Hearings*, *supra* note 56, at 170 (statement of Sen. DeConcini).

58. *Id.*

59. *See, e.g., id.* at 169 (owner of small restaurant spent $30,000 in successful fight against Labor Department demand for $54,000 in back pay allegedly owed to employees); *id.* at 120 ("massive and unbelievably expensive proceeding" brought by SEC against small corporation ultimately dismissed by district court judge as "irresponsible and reckless"); *see generally id.* at 54-156 (testimony from business representatives on high litigation costs faced when contesting unjustified government actions); *see also supra* note 54 (testimony received from small businessmen on high litigation costs).

60. H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 8, (1980); *see also id.* at 6 (committee provided with "numerous examples" of indefensible government actions against individual small business owners during hearings).

61. *See, e.g., House Small Business Hearings*, *supra* note 56 at 169 (small businessman spent $3,000 to successfully contest $25 OSHA fine); *see generally id.* at 54-156 (testimony from business representatives on high litigation costs faced to contest unjustified government actions); *see also supra* note 54 (testimony received from small businessmen faced with choice between contesting fine and paying high litigation costs or accepting relatively small fine).

majority of their legal costs when seeking legal fees under the Act.[62] Furthermore, because the provision allowing recovery when the government's position was not substantially justified has only a limited three-year lifespan, a construction denying litigants large portions of their legal expenses in the Act's early years would severely reduce the Act's effectiveness.[63]

Retroactive application of the EAJA also furthers the second goal of the Act—deterring excessive regulation and unreasonable exercise of governmental authority.[64] Congress recognized that requiring agencies to pay fee awards ordered under the EAJA out of their own budgets would encourage more responsible government action.[65] Senator Nelson, cosponsor of the bill, noted that by allowing fee-shifting against the offending agency rather than awarding fees to be paid from the general revenues, the EAJA would have a "chilling effect on presently unrestrained regulators."[66] Under this rationale, refusing to apply the EAJA retroactively would frustrate congressional intent. The minimal liabilities that would be imposed on agencies if the Act were given exclusively prospective application cannot be expected to have nearly the deterrent effect for future government conduct that the comparatively large liabilities imposed by retroactive application would have. These larger liabilities would truly bring home to the agencies the new responsibility and self-restraint imposed on them by the EAJA.

Limiting the EAJA's application to post-1981 fees also frustrates the Act's deterrence function by interfering with its oversight provisions.[67] By requiring annual reports on the number, nature, and amount of fee awards that agencies

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62. Retroactive application of the Act would also further the goal of spreading the cost of challenging unfair government actions. *See* Nunes-Correia v. Haig, 543 F. Supp. 812, 814 n.2, 816 (D.D.C. 1982) (awarding fees for services rendered throughout pending cases would further goal of equitably spreading costs of challenging unfair government regulations).

63. *See supra* note 31 and accompanying text (Act's sunset provision).

64. *See, e.g.*, H.R. REP. No. 1418, 96th Cong., 2d Sess. 12, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4991 (fee-shifting is "an instrument for curbing excessive regulation and the unreasonable exercise of Government authority"); S. REP. No. 253, 96th Cong., 1st Sess. 7 (1979) (fee-shifting curbs excessive regulation and unreasonable exercise of government authority); 125 CONG. REC. 21,443 (1979) (statement of Sen. Nelson) (fee-shifting "will have a chilling effect on presently unrestrained regulators"); 125 CONG. REC. 21,437 (1979) (statement of Sen. Domenici) (one purpose of EAJA to "insure against capricious and arbitrary Federal regulation"); AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 54 (one purpose of Act was to curb excessive regulation and unreasonable exercise of government authority).

65. *See Equal Access to Justice Act of 1979: Hearings on S. 265 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 2 (1979) (statement of Sen. DeConcini) ("[t]he bill . . . recognizes that the most persuasive way to make an agency assume a more responsible posture is to affect its pocketbook"); H.R. REP. No. 1005, pt. I, 96th Cong., 2d Sess. 11 (1980) (requiring agencies to pay fees out of their own budgets intended to make agencies more accountable for their actions).

The Act directs agencies to pay fees and expenses awarded in adversary adjudications or civil actions under the Act from funds "made available to the agency, by appropriation or otherwise." 5 U.S.C. § 504(d)(1) (Supp. V 1981); 28 U.S.C. § 2412(d)(4)(A) (Supp. V 1981). The agency found to have acted in bad faith must also pay fees awarded under the common law bad faith doctrine. 28 U.S.C. § 2412(c)(2). Fee awards made pursuant to other common law fee-shifting doctrines or statutory fee-shifting provisions are to be paid by the General Accounting Office from the permanent indefinite appropriation provided by 28 U.S.C. § 2414 (1976 & Supp. V 1981) and 28 U.S.C. § 2517 (Supp. V 1981). 28 U.S.C. § 2412(c)(2).

66. 125 CONG. REC. 21,443 (1979).

67. The Act requires the Chairman of the Administrative Conference of the United States and the Director of the Administrative Office of the United States Courts to make annual reports to Congress on the amount of fees and other expenses awarded in adversary adjudications and judicial proceedings

paid in the preceding fiscal year,[68] Congress intended that the Act would provide an objective measure to determine those agencies that were abusing their regulatory authority.[69] Denying pre-Act fees would give Congress a distorted picture of which agencies had engaged in the kinds of unjustified activities the EAJA was designed to discourage, particularly during the first year or two of the Act. Because fees are awarded only at the end of a lawsuit, the awards made during any fiscal year for litigation that has been ongoing from preceding years will necessarily be in part for legal expenses incurred during those years. Consequently, if only post-Act fees are allowed, the aggregate fee award figures for the second and third years of the Act's effective period would include expenses from at least one preceding year, while the figure for the first year would not. The figures for the various years would not be comparable, and the figure for the first year would be far less than the total amount of fees actually incurred. Because the first year's figures would underreport the amount of unwarranted government action, the figure for fees awarded during the Act's second year would falsely indicate a substantial increase in unjustified agency actions. In contrast, retroactive application of the EAJA would allow Congress to make reliable year-by-year comparisons of the total amount

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involving the United States during the preceding fiscal year. 5 U.S.C. § 504(e) (Supp. V 1981); 28 U.S.C. § 2412(d)(5) (Supp. V 1981).

68. The Act requires that the annual reports describe the "number, nature, and amount of the awards, the claims involved in the controversy, and any other relevant information which may aid the Congress in evaluating the scope and impact of such awards." 5 U.S.C. § 504(e) (Supp. V 1981); 28 U.S.C. § 2412(d)(5) (Supp. V 1981).

69. *See House Small Business Hearings*, *supra* note 56, at 52 (statement of Rep. Roth) (EAJA would provide gauge of which agencies act irresponsibly so Congress could scrutinize agencies' budget requests each year); *Equal Access to Justice Act of 1979: Hearings on S. 265 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 40 (1979) (statement of Sen. DeConcini) (fee awards made by agencies under EAJA "will provide an objective gauge of whether or not an agency is engaging in excessive, unreasonable regulations"); H.R. REP. No. 1005, pt. I, 96th Cong., 2d Sess. 11 (1980) (impact of fee awards on agency budgets would provide "quantitative measure of agency abuses and would encourage congressional oversight of departmental and agency practices and regulations").

Because the annual report of the Administrative Office of the United States Courts is prepared for the year ending June 30 and not the fiscal year, the first report on the EAJA's impact in judicial proceedings covers only the Act's first nine months. ADMINISTRATIVE OFFICE OF U.S. COURTS, REPORT BY THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS ON REQUESTS FOR FEES AND EXPENSES UNDER THE EQUAL ACCESS TO JUSTICE ACT OF 1980: OCT. 1, 1981 THROUGH JUNE 30, 1982, at 1 (Sept. 22, 1982) [hereinafter REPORT OF ADMINISTRATIVE OFFICE]. This report, however, offers some interesting insights into the Act's real impact. During the first nine months the EAJA was in effect, only 30 petitions for fees and expenses under the Act were disposed of in federal courts. *Id.* Of those 30 petitions, 13 were granted, with a total of about $683,500 in fees and expenses awarded in judicial proceedings under the EAJA. *Id.* at 2. In contrast, the Congressional Budget Office predicted awards of approximately $68 million in 3,500 cases during the Act's first fiscal year. H.R. REP. No. 1418, 96th Cong., 2d Sess. 23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002. *See also infra* notes 92-98 (projections of EAJA's costs). According to the report, most of the fee awards were small; two of the thirteen cases in which awards were made accounted for 93% of the total amount awarded. REPORT OF ADMINISTRATIVE OFFICE, *supra*, at 3. Nearly $436,000 was awarded in one case against four federal agencies, and $200,000 was awarded in one EAJA petition against the Department of Defense. *Id.* About 43% of the requests for fees made during the Act's first months were granted. *Id.* at 2.

It is, of course, impossible to measure the impact of public ignorance of the potential for recovering attorney's fees under the EAJA on the number of cases in which awards were requested and granted. In addition, figures for July 1, 1982, to October 1, 1982, are not yet available. Nevertheless, it appears that neither the total amount awarded nor the total number of cases in which awards were made during the Act's first fiscal year will even remotely approximate the $68 million that the CBO projected would be awarded in 3,500 cases up to October 1, 1982.

federal agencies are required to pay under the EAJA. Moreover, because the Act's substantial-justification provision has only a three-year lifespan,[70] early, reliable figures of the amounts of fees awarded against particular agencies would further facilitate congressional oversight of the Act's effects.

A third goal Congress expressed in passing the EAJA was to create incentives for private litigants to contest unreasonable government actions.[71] The EAJA's incentive function is the only one of the three purposes expressed in the Act and its legislative history[72] that is not clearly furthered by application of the Act to fees incurred before its effective date. Courts both favoring and opposing retroactive application of the Act correctly observe that the high cost of litigation did not deter those individuals who challenged government action before the EAJA's effective date.[73] The United States District Court for the District of Columbia acknowledged in *Nunes-Correia v. Haig*,[74] for example, that litigants could not change their behavior in response to the Act's incentives until after the EAJA was passed and its effective date established.[75] Arguably, however, the EAJA's incentive effect could have been felt for almost a year before its effective date. President Carter signed the Act into law on Oc-

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70. *See supra* note 31 and accompanying text (Act's sunset provision).

71. EAJA § 201(c)(1), 5 U.S.C. § 504 note (CONGRESSIONAL FINDINGS AND PURPOSES) (Supp. V 1981) (purpose of Act is "to diminish the deterrent effect of seeking review of, or defending against, governmental action by providing . . . an award of attorney fees . . . and other costs against the United States"). *See also House Judiciary Hearings*, *supra* note 55, at 24 (EAJA intended to encourage challenges to unreasonable agency actions); S. REP. NO. 253, 96th Cong., 1st Sess. 5 (1979) (EAJA "focuses primarily on those individuals for whom cost may be a deterrent to vindicating their rights"); 125 CONG. REC. 21,435 (1979) (statement of Sen. DeConcini) (EAJA intended to "affirmatively encourage citizens to challenge actions which they believe to be unreasonable or irresponsible"); Statement on Signing [EAJA] Into Law, 16 WEEKLY COMP. PRES. DOC. 2381, 2381 (Oct. 27, 1980) (EAJA will "encourage business people with limited resources to resist unreasonable Government conduct").

72. Although creating incentives to litigate is the only purpose stated in the Act itself, 5 U.S.C. § 504 note (Supp. V 1981), this goal and compensating victims of unreasonable government action for litigation costs were so commonly referred to as dual functions of the Act that it is unlikely that either Congress or the President valued one over the other; in fact, the Act's sponsors commonly expressed the compensation function as the EAJA's primary goal during hearings and floor discussion on the measure. *See, e.g., House Judiciary Hearings*, *supra* note 55, at 24 (statement of Sen. DeConcini) (purpose of EAJA "goes beyond making whole those who have been the victims of unreasonable government action. It is also intended to affirmatively encourage citizens to challenge actions which they believe to be unreasonable."); *House Small Business Hearings*, *supra* note 56, at 53 (statement of Rep. McDade) (EAJA intended to both give small businessman fairer stake in defending against government actions and make regulatory agencies more responsible); 125 CONG. REC. 21,443 (1979) (statement of Sen. Nelson) (fee-shifting both redresses injustice to victim caused by government and chills unrestrained regulators); *id.* at 21,435 (1979) (statement of Sen. DeConcini) (purpose of EAJA "is not only to compensate people who have been the victims of arbitrary Government actions. It is also intended to affirmatively encourage citizens to challenge actions which they believe to be unreasonable or irresponsible."); Statement on Signing [EAJA] Into Law, 16 WEEKLY COMP. PRES. DOC. 2381, 2381 (Oct. 27, 1980) (EAJA provides "financial relief . . . to small businesses that prevail in litigation when the Government's position is found to be arbitrary" and encourages "business people with limited resources to resist unreasonable Government conduct").

73. *See* Allen v. United States, 547 F. Supp. 357, 361 (N.D. Ill. 1982) (high litigation costs did not deter individuals who challenged governmental action before Act's effective date from protecting their interests against government); *infra* text accompanying notes 74-75 (discussing *Nunes-Correia* case); *see also* AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 54 (retroactive award of attorney fees would not further Act's goal of encouraging parties to contest unreasonable governmental action). *But see* Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 (D.D.C. 1982) (construing Act to bar recovery of fees incurred before October 1, 1981 would remove incentive to sue by diminishing litigants' recovery).

74. 543 F. Supp. 812 (D.D.C. 1982).

75. *Id.* at 814 n.2.

tober 21, 1980.[76] The law plainly provided in section 208 that it would apply to adjudications "pending on" October 1, 1981.[77] It appears highly likely that during the period between these two dates some private individuals, particularly those facing a deadline for action, would have contested government actions out of the expectation that they might recover their attorneys' fees under the EAJA. This expectation would have been reasonable because of the probability, given the testudineous pace of government litigation, that the resulting adjudications would still be pending on the Act's effective date. Failure to apply the EAJA retroactively would belie this incentive effect. In any event, as the *Nunes-Correia* court stated, creating incentives to litigate was not the only goal Congress had in mind when passing the EAJA; indeed, it may not even have been the Act's primary goal.[78]

Even though refusing to apply the EAJA retroactively would frustrate the Act's goals of compensating victims of unreasonable action and deterring overregulation by federal agencies, the United States District Court for the Northern District of Illinois held in *Allen v. United States*[79] that the EAJA cannot be applied to pre-Act fees because retroactivity would not further any of the Act's purposes.[80] The *Allen* court relied extensively[81] on *Brookfield Construction Co. v. United States*,[82] a 1981 United States Court of Claims decision that refused to apply the interest penalties provided by the Contract Disputes Act of 1978[83] retroactively against the United States.[84] The Justice Department also has relied on *Brookfield Construction* to argue for the same conclusion.[85]

Although an analysis of congressional purposes is relevant when determining whether the imposition of retroactive liability is a fair interpretation of the Act, the purpose and legislative history of the EAJA and the Contract Disputes Act differ so fundamentally that the holding in *Brookfield Construction* is quite irrelevant to a reading of the EAJA. According to the *Brookfield Construction*

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76. 16 WEEKLY COMP. PRES. DOC. 2381 (Oct. 21, 1980) (statement on signing H.R. 5612, Pub. L. No. 96-481, into law); EAJA, Pub. L. No. 96-481, 94 Stat. 2321, 2321 (law dated Oct. 21, 1980).

77. EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981), 28 U.S.C. § 2412 note (EFFECTIVE DATE OF 1980 AMENDMENT) (Supp. V 1981).

78. *Nunes-Correia*, 543 F. Supp at 814 n.2, 816 (if creating incentives not primary purpose, applying Act retroactively accomplishes goal of equitably distributing costs of successful challenges of unfair government actions). *See also* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1160 (N.D. Ill. 1982) (refusing to apply Act retroactively is contrary to Act's purpose of spreading litigation costs); *supra* note 72 (discussing relative importance to Congress of Act's incentive and compensation functions).

79. 547 F. Supp. 357 (N.D. Ill. 1982).

80. *Id.* at 361.

81. *Id.* at 360-61.

82. 661 F.2d 159 (Ct. Cl. 1981).

83. 41 U.S.C. §§ 601-613 (Supp. V 1981).

84. *See Brookfield Construction*, 661 F.2d at 163-66 (without legislative history or statutory direction to the contrary, large liability imposed by awarding pre-Act interest, absence of congressional purpose furthered by awarding pre-Act interest, and traditional caution against imposing interest on the government bar retroactive application of Contract Disputes Act).

85. AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 52-56.

The *Allen* court's and the Justice Department's analyses of the EAJA's retroactive application are based almost entirely on the three factors, *supra* note 84, used in *Brookfield Construction*. *See Allen*, 547 F. Supp. at 360-61 (*Brookfield* factors appropriate to determination of whether fees incurred before EAJA's effective date should be awarded); AWARD OF ATTORNEY FEES UNDER EAJA, *supra*, at 52-56 (three-part *Brookfield* analysis against retroactive application of Contract Disputes Act applies with equal force to award of retroactive attorneys' fees under EAJA).

court, one "essential policy" for allowing interest under the Contract Disputes Act is to provide "additional inducement for the settlement of claims short of litigation."[86] The court correctly recognized that allowing pre-Act interest would not have furthered this purpose because there had been no pre-Act incentive for the contracting officer to expedite consideration of claims.[87] Applying the timetables and interest penalties of the Contract Disputes Act retroactively would therefore have imposed an unfair burden on the government.[88] Applying the EAJA to pre-Act fees, however, clearly furthers the Act's purposes of compensating victims of unfair government actions, aids in deterring the government from litigating unjustified positions, facilitates the EAJA's oversight function, and arguably serves the Act's incentive functions.

C. COST ESTIMATES PREPARED FOR THE EAJA SUPPORT RETROACTIVE APPLICATION

Both those favoring and those opposing retroactive application of the EAJA have found support for their respective positions in the estimates of the Act's cost prepared by the Congressional Budget Office (CBO). Both the *Allen* court and the Justice Department copied the *Brookfield Construction* court's use of cost estimates in order to detect congressional intent opposing retroactive application of the EAJA.[89] Courts upholding the EAJA's application to pre-Act fees, however, have relied on the estimates to reach precisely the opposite conclusion.[90] Because more persuasive indicators of congressional intent are available,[91] the CBO estimates should not be conclusive evidence of Congress'

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86. *Brookfield Construction*, 671 F.2d at 164 n.12.

87. *Id.* at 164-65.

88. *Id.* (parties not aware of or bound by Act's time limits during pre-Act periods, so unfair to impose interest penalties on government for failure to comply with Act's provisions prior to effective date).

89. *See infra* note 105 and accompanying text (*Allen* court held and Justice Department argues retroactive application of EAJA precluded by analogy to *Brookfield Construction*).

90. *Compare* Nunes-Correia v. Haig, 543 F. Supp. 812, 815-16 (D.D.C. 1982) (distribution of long-lived and short-lived cases terminated in 1982 and subsequent years will remain constant; therefore, awarding fees incurred prior to October 1, 1981, in cases pending on that date would result in constant expenditures; Congress' acceptance of CBO estimate's assumption that the Act's cost would vary only with historical yearly increase in caseloads, inflation, and Act's incentive effects demonstrates Congress "clearly intended" EAJA to apply retroactively) *and* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1160-61 (N.D. Ill. 1982) (estimated yearly cost of EAJA varies only with historical growth in number of cases involving government, reduced deterrent to litigation, and inflation; no justification for reading cost estimates as anticipating bifurcation of cases on October 1, 1981) *with* Allen v. United States, 547 F. Supp. 357, 361 (N.D. Ill. 1982) (CBO cost estimate shows outlays starting low in fiscal year 1981 and increasing sharply in each following year; if retroactivity intended, outlay of funds would be immediately large and steady throughout Act's life) *and* AWARD OF ATTORNEYS FEES UNDER EAJA, *supra* note 18, at 53 (CBO cost estimates predict substantial federal liability during Act's first year and substantially greater liability the following year; if retroactivity intended, Congress would have expected substantially greater exposure during first year, when old claims with large accumulated fees being settled, than in second or subsequent years).

One other court has found the argument that CBO estimates are inconsistent with retroactive application of the EAJA sufficiently persuasive to reserve judgment on the EAJA's application to pre-Act fees. *See* Commodity Futures Trading Comm'n v. Rosenthal & Co., 537 F. Supp. 1094, 1096-97 & n.3 (N.D. Ill. 1982) ("perhaps most notably" government argues "with at least surface persuasiveness" that retroactive application illogical in light of large annual increase in CBO estimate).

91. *See supra* notes 51-72 and accompanying text (House and Senate hearings, reports, and debates demonstrate that congressional purposes in passing EAJA support retroactive application).

intentions in passing the EAJA. Insofar as the CBO estimates lend credence to either position, however, they support retoactivity.

The CBO estimates were based on the average legal fees awarded against the federal government under other fee-shifting statutes,[92] some of which had been applied retroactively.[93] These average awards were multiplied by an estimate of the total number of cases in which the United States could not or would not be able to show substantial justification of its position under the EAJA.[94] The figure obtained for the first year of the Act was then increased by the historical yearly growth in caseloads,[95] inflation,[96] and the estimated impact of the Act's incentive effect.[97]

Had the CBO assumed that the EAJA would not apply retroactively, its estimates would not have been based on average awards made under other fee-shifting statutes. If the Act were not to be applied retroactively, fees awarded in cases brought before its effective date would cost the government less than fees awarded in cases intitiated after October 1, 1981. Under this assumption, the CBO would have had to reduce the estimated average award in cases with

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92. For example, the CBO estimated the awards in judicial proceedings that would be made under the EAJA by taking the average awards made under other fee-shifting statutes during the most recent year for which figures were available and increasing it to reflect inflation between the base year and the first fiscal year the Act would be in effect. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002; H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 14 (1980); S. REP. NO. 253, 96th Cong., 1st Sess. 11 (1979). The CBO estimated that an average fee award against the United States was approximately $18,000 in 1977. That figure was inflated to $25,000 for fiscal year 1982 and increased in successive years by the CBO's projection of the Consumer Price Index. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002.

The CBO's estimated average award against the United States in judicial proceedings was based on two surveys of awards in cases involving title VII, Privacy Act, and Freedom of Information Act litigation in 1977. H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 14 (1980); S. REP. NO. 253, 96th Cong., 1st Sess. 11 (1979).

93. The fee-shifting provision of the Freedom of Information Act (FOIA), 5 U.S.C. § 552(a)(4)(E) (1976), has been applied retroactively in suits involving the federal government, despite the absence of an explicit waiver of sovereign immunity against pre-Act fees in cases that were pending on the Act's effective date. *See infra* notes 163-74 and accompanying text (retroactive application of FOIA in absence of statutory direction or specific legislative history supports retroactive interpretation of EAJA).

94. The CBO based its estimates of the number of cases in which fees would be awarded under the EAJA on the total number of cases involving the United States that were terminated during 1979, the most recent year for which figures were available. The CBO assumed that the United States would lose 15 to 20% of all judicial proceedings and 55% of all administrative adjudications. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 21, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5001-02; H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 14 (1980). The CBO further assumed the United States could not or would not show substantial justification in 25% of the cases and proceedings lost. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 21, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5001-02. Under these assumptions, the CBO predicted that awards would have been made in about 3,000 cases had the EAJA been in effect in 1979 and 2,700 administrative adjudications had the EAJA been in effect in 1978. *Id.*

95. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 21, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5001-02. The 3,000 cases for which fees would have been awarded had the EAJA been in effect in 1979 was inflated by six percent per year to reflect historical growth in caseloads. Based on that historical growth, the CBO projected that 3,500 awards would be made in fiscal year 1982, 3,700 in fiscal year 1983, and 4,000 in fiscal year 1984. *Id.*

96. *See supra* note 92 (discussing adjustment for inflation).

97. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002; H.R. REP. NO. 1005, pt. I, 96th Cong., 2d Sess. 14-15 (1980); S. REP. NO. 253, 96th Cong., 1st Sess. 11 (1979). The CBO increased the total annual costs under the Act by 5% in fiscal year 1982, 10% in fiscal year 1983, and 15% in fiscal year 1984 to reflect the EAJA's impact on the size of awards and amount of litigation involving the federal government. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002.

pre-Act fees. But the CBO made no attempt to reduce its estimates to account for fees incurred before the Act's effective date.[98]

Not only the CBO's method of computing the EAJA's costs but also the total cost estimates themselves are consistent with retroactive application of the Act. The Justice Department and the *Allen* court reason that if Congress had intended to allow recovery of pre-Act fees, the CBO would have predicted substantially greater liability in the Act's first year, when old claims with large accumulated fees were being settled, than in the Act's second or third years.[99] Taking a contrary position, the United States District Court for the District of Columbia in *Nunes-Correia v. Haig*[100] pointed out the defects in this argument. All else being equal, the court argued, the number of long-lived and short-lived cases terminated in any year can be expected to remain constant.[101] Therefore, awarding fees for the entire litigation in cases pending on or after the Act's effective date should result in constant expenditures over the years.[102] This outcome is consistent with the CBO's projections, which assumed that the Act's annual costs would vary only with the historical yearly increases in caseloads, inflation, and the Act's incentive effects.[103] Therefore, to the extent

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98. The CBO estimated that the average award paid by the United States in judicial proceedings under other fee-shifting statutes in 1977 was about $18,000. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002. That figure was inflated to $25,000 for fiscal year 1982, and multiplied by an estimated 3,500 cases terminated that year for which the government could not or would not show substantial justification. *Id. See infra* note 104 (discussing CBO calculations in detail). If the Act was not intended to apply retroactively, however, the CBO should have reduced the $25,000 figure by an amount representing estimated attorneys' fees incurred before October 1, 1981 in the estimated number of cases brought before that date but terminated in 1982.

99. Allen v. United States, 547 F. Supp. 357, 361 (N.D. Ill. 1982) (CBO cost estimate shows outlays starting low and increasing sharply; if retroactivity intended, outlay would be immediately large and steady throughout life of Act); AWARD OF ATTORNEY FEES UNDER THE EAJA, *supra* note 18, at 53 (CBO estimates predict substantial liability during Act's first year and substantially greater liability in following year; if retroactivity intended, Congress would have expected substantially greater exposure during first year, when old claims with large accumulated fees being settled, than in second or subsequent years).

100. 543 F. Supp. 812 (D.D.C. 1982).

101. *Id.* at 815.

102. *Id.* The *Nunes-Correia* court noted that if the Act does not cover pre-October 1981 fees incurred in pending cases, annual expenditures would increase as the total amount of post-Act fees increases. The court reasoned that cases filed long before October 1, 1981 and terminated shortly after that date would present less post-October 1981 work than cases terminated long after the EAJA's effective date. *Id.* Therefore, restricting the Act to post-October 1981 fees would result in a sharp rise in the EAJA's costs during its early years, with costs eventually leveling off as the number of cases with pre-Act fees approached zero. *Id.* The annual increase in the CBO estimates, however, only reflect the historical increase in litigation involving the government, inflation, and the Act's incentive effects and do not level off. *See supra* notes 92-97 and accompanying text (discussing computation of CBO cost estimates). The CBO's failure to consider the denial of pre-Act fees as a variable in computing the Act's costs indicates that the estimates were based on an assumption that the EAJA would apply retroactively. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1160-61 (N.D. Ill. 1982) (CBO estimates based on number of cases government will lose under EAJA and average award in each case, increased by historical growth in cases involving government, Act's incentives, and inflation; no justification for reading cost estimates as anticipating bifurcation of cases on Act's effective date).

The *Allen* court recognized that if retroactivity had been intended annual outlays under the Act would be level over the life of the Act. Allen v. United States, 547 F. Supp. 357, 361 (N.D. Ill. 1982). In ruling against retroactivity, however, the *Allen* court failed to take account of the CBO's express explanation of the variables that increased its estimates of the Act's costs for successive years.

103. *See supra* notes 92-97 and accompanying text (basis for CBO budget estimates on EAJA's projected cost to the federal government).

Furthermore, the cost estimates of the House Judiciary Committee and the Justice Department itself

that cost estimates should be given significant weight in determining congressional intent, Congress' acceptance of the CBO's express assumptions reflected in the total cost estimates is evidence that Congress intended that the EAJA apply retroactively.[104]

Even though the CBO estimates are consistent with retroactive application of the EAJA, both the Justice Department and the *Allen* court have reasoned that the estimates demonstrate Congress did not intend to apply the Act retroactively. Relying on the rationale of *Brookfield Construction*, the *Allen* court held and the Justice Department maintains that the EAJA should not be applied retroactively because such application would impose large liability on the

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are consistent with retroactive application of the EAJA because both predicted that annual costs would remain constant over the life of the Act. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 20, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4999 (House Judiciary Committee estimates cost of $92 million for each fiscal year 1982-1984 and $20 million for fiscal year 1985 [smaller allocation for 1985 reflects Act's expiration date]); S. REP. NO. 253, 96th Cong., 1st Sess. 12 (1979) (Department of Justice estimates annual costs of $125 million per year).

104. It is important to note, however, that the CBO cost estimates may be suspect evidence of congressional intent regarding retroactivity for several reasons. First, there is no indication that Congress expressly considered the impact of awarding all fees in pending cases versus awarding just those fees incurred after the Act's effective date on the Act's annual costs. The different conclusions courts have reached after analyzing the CBO estimates demonstrate that interpreting the cost estimates is unreliable. *See* note 90 and accompanying text (courts examining CBO estimates to determine congressional intent on EAJA's retroactivity have come to conflicting conclusions).

Second, because of the sheer number of cases affected by the EAJA and the absence of any similar statute as a basis for predicting the Act's potential costs, many of the assumptions relied upon by the CBO to predict the EAJA's costs were necessarily without adequate statistical support. For example, although the CBO could determine the average number of cases that the federal government loses each year, the CBO admitted that it had no statistical basis for its assumption that the United States could not or would not show substantial justification in 25% of those cases. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5001. *See supra* note 94 (CBO computation of number of cases in which fees would be awarded). Similarly, the CBO's justification for its decision to apply a $25,000 award to 50% of the cases in which awards were made in judicial proceedings and a $15,000 award in the remainder to reflect cases settled without court action lacks justification. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 22-23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 5002 ($18,000 average award under existing fee-shifting statutes inflated to $25,000 for fiscal year 1982 and applied only to 50% of judicial cases; the committee estimated $15,000 average award applied to remainder, reflecting cases settled at lower cost). Average awards paid by the government under other fee-shifting statutes would have taken into account cases in which lower fees were incurred due to early settlement. Therefore, the CBO's decision to reduce the average award under the EAJA is without an adequate statistical justification.

The CBO also failed to justify its assumption that annual cost increases by 5, 10, and 15% during the first, second, and third years of the Act, respectively, were due to the Act's impact on the size of awards and the number of cases filed. *See supra* note 97 (discussing estimated impact of Act's incentive effect on annual costs). The rounded figures representing the projected annual increases and the complete absence of support for the assumptions indicates that the projections were purely arbitrary.

Finally, the CBO estimates were not the only ones available to Congress on the EAJA's predicted costs. The House and Senate Judiciary Committees, the Department of Justice, and the Office of Management and Budget also prepared cost estimates, and all varied widely, from $16 million to $36 million annual liability predicted by the Senate Judiciary Committee to $205 million first-year cost predicted by the OMB. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 20, 23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4999, 5003 (House Judiciary Committee estimates $92 million per year and Office of Management and Budget estimates $205 million for first year); S. REP. NO. 253, 96th Cong., 2d Sess. 12 (1979) (Senate Judiciary Committee estimates $16 million to $36 million per year and Department of Justice estimates $125 million per year). Furthermore, the House Judiciary Committee expressly differed with the CBO's assumptions regarding the number of cases the EAJA would affect. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 20, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4999 (committee accepts CBO estimate for fiscal year 1982, but believes EAJA will cause decrease in administrative proceedings and civil actions that federal government will litigate without substantial justification).

federal government.[105] Significant differences between the Contract Disputes Act[106] construed in *Brookfield Construction* and the EAJA, however, render any comparison between the two statutes meaningless.[107] The *Brookfield Construction* court determined that Congress passed the Contract Disputes Act with the express understanding that it would impose no additional costs on the federal government.[108] Allowing awards of pre-Act interest, however, would cost the government a significant amount of money.[109] The plaintiff in *Brookfield Construction*, for example, sought more than $1 million, most of it for pre-Act interest.[110] In addition to the fact that the Act's purpose would not be furthered by retroactive application,[111] Congress' failure to acknowledge this considerable expense persuaded the court that Congress did not intend the Act to apply to pre-Act interest.[112] In contrast, the EAJA's cost estimates demonstrate that Congress recognized that the Act would impose significant costs on the federal government.[113]

D. JUDICIAL INTERPRETATION OF OTHER FEE-SHIFTING STATUTES SUPPORTS RETROACTIVE APPLICATION

Congress enacted a variety of attorneys' fee-shifting statutes in the 1960's and 1970's to allow prevailing private litigants to collect their attorneys' fees from state or federal agencies that interfered with the enforcement of civil rights or other federal statutes furthering the public interest.[114] As with private suits eligible for fee awards under the EAJA, Congress recognized that private suits to enforce other statutes furthered important public policies embodied in those laws and that both fairness and continued vigorous enforcement re-

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105. *Compare Brookfield Construction*, 661 F.2d at 163 (allowing retroactive interest penalties under Contract Disputes Act of 1978, 41 U.S.C. §§ 601-613 (Supp. V 1981), would impose very large liability on government, unacknowledged in Act's legislative history) *with Allen*, 547 F. Supp. at 361 (as in *Brookfield*, applying Act retroactively could place large liability on government) *and* AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 52-53 (as in *Brookfield*, allowing retroactive attorneys' fees certainly would impose large liability on United States).

106. 41 U.S.C. §§ 601-613 (Supp. V 1981).

107. *See supra* notes 86-88 and accompanying text (discussing differing purposes behind Contract Disputes Act and EAJA).

108. *Brookfield Construction*, 661 F.2d at 164.

109. *Id.*

110. *Id.* at 163.

111. *See supra* notes 86-88 and accompanying text (discussing *Brookfield Construction* court's analysis of purposes of Contract Disputes Act and conclusion that Act not furthered by allowing awards of pre-Act interest).

112. *See Brookfield Construction*, 661 F.2d at 164 (Congress' striking failure to consider huge additional potential liability persuasive, in absence of contrary considerations, that retroactive application not intended).

113. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1159 n.3 (N.D. Ill. 1982) (EAJA, with estimated first-year cost of close to $100 million, contrasts sharply with Contract Disputes Act, with no estimated annual cost to federal government). *See also supra* note 104 (estimates of EAJA's first-year costs ranged from $16 million to $205 million); notes 89-103 and accompanying text (analysis of EAJA cost estimates).

114. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 8, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4987 (Congress has authorized fees in variety of contexts, usually to effectuate "specific and compelling" public interest); S. REP. NO. 253, 96th Cong., 1st Sess. 4 (1979) (Congress authorized statutory exceptions to American rule for fee recovery in variety of contexts, usually to effectuate "specific and compelling" public interest). Fee-shifting provisions of this nature appear in the Voting Rights Act of 1965, 42 U.S.C. § 1973*l*(e) (1976), the Freedom of Information Act, 5 U.S.C. § 552(a)(4)(E) (1976), and the Civil Rights Attorney's Fees Awards Act of 1976, 42 U.S.C. § 1988 (Supp. IV 1980).

quired reimbursement to private litigants for their legal fees.[115]

In 1973 the Supreme Court rendered a significant ruling on the retroactive application of fee-shifting statutes. In *Bradley v. Richmond School Board*[116] the Court approved compensation for legal services rendered before the effective date of the fee-shifting provision of the Education Amendments of 1972.[117] Since then courts have explicitly or implicitly relied on *Bradley* in construing the Education Amendments of 1972,[118] the Voting Rights Act of 1965,[119] the Freedom of Information Act,[120] and the Civil Rights Attorney's Fees Awards Act of 1976[121] to allow awards of attorneys' fees incurred before the effective dates of the statutes, despite the absence of an explicit waiver of state or federal sovereign immunity against pre-act fees incurred in pending

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115. *See* Underwood v. Pierce, 547 F. Supp. 256, 260 & n.6 (C.D. Ca. 1982) (fee-shifting provision of Education Amendments of 1972, Civil Rights Attorney's Fees Awards Act of 1976, and EAJA share purpose of encouraging certain aggrieved persons to seek redress in courts). *See also supra* note 114 (statutory exceptions to American rule and federal sovereign immunity authorized to effectuate specific and compelling public interest).

116. 416 U.S. 696 (1974).

117. *Id.* at 709, 724 (citing Education Amendments of 1972, Pub. L. No. 92-318, tit. VII, § 718, 86 Stat. 235, 369 (codified at 20 U.S.C. § 1617 (1976) and repealed 1979)). Section 718 of the Education Amendments of 1972 provides:

> Upon the entry of a final order by a court of the United States against a local educational agency, a State (or any agency thereof), or the United States (or any agency thereof), for failure to comply with any provision of this chapter or for discrimination on the basis of race, color, or national origin in violation of title VI of the Civil Rights Act of 1964, or the fourteenth amendment to the Constitution of the United States as they pertain to elementary and secondary education, the court, in its discretion, upon a finding that the proceedings were necessary to bring about compliance, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.

20 U.S.C. § 1617 (1976) (repealed 1979).

118. Pub. L. No. 92-318, tit. VII, § 718, 86 Stat. 235, 369 (codified at 20 U.S.C. § 1617 (1976) and repealed 1979). *See, e.g.,* Arthur v. Nyquist, 426 F. Supp. 194, 196 (W.D.N.Y. 1977) (*Bradley* applied to case involving retroactive application of fee-shifting provision of Education Amendments of 1972); Dowell v. Board of Educ., 71 F.R.D. 49, 57 (W.D. Okla. 1976) (as in *Bradley*, no exceptional circumstances to bar award of attorneys' fees under Education Amendments of 1972, even though services rendered prior to effective date); Armstead v. Starkville Mun. Separate School Dist., 395 F. Supp. 304, 308-09 (N.D. Miss. 1975) (same).

119. 42 U.S.C. § 1973/(e) (1976). *See* Lytle v. Commissioners of Election, 541 F.2d 421, 424 (4th Cir. 1976) (*Bradley* principle that appellate court to apply law in effect at time decision is rendered supports retroactive application of fee-shifting provision of Voting Rights Act of 1965), *cert. denied*, 438 U.S. 904 (1978); Torres v. Sachs, 538 F.2d 10, 13 (2d Cir. 1976) (under principles of *Bradley*, Voting Rights Act of 1965 amendment permitting fee award applicable to cases pending at time of enactment).

120. 5 U.S.C. § 552(a)(4)(E) (1976). *See* Cuneo v. Rumsfeld, 553 F.2d 1360, 1367 (D.C. Cir. 1977) (as in *Bradley*, successful FOIA action vindicates important congressional policies and benefits public generally; thus, court should apply fee-shifting amendment retroactively); Consumers Union of United States, Inc. v. Board of Governors of the Fed. Reserve Sys., 410 F. Supp. 63, 64-65 (D.D.C. 1975) (in light of *Bradley*, award of fees incurred prior to effective date of FOIA amendments "just and proper").

121. 42 U.S.C. § 1988 (Supp. IV 1980). *See, e.g.,* Corpus v. Estelle, 605 F.2d 175, 180 (5th Cir. 1979) (citing *Bradley*, court holds that Civil Rights Attorney's Fees Awards Act of 1976 should be applied retroactively unless manifest injustice would result), *cert. denied*, 445 U.S. 919 (1980); Monroe v. County Bd. of Educ., 583 F.2d 263, 264-65 (6th Cir. 1978) (relying on *Bradley*, court retroactively applies Civil Rights Attorney's Fees Awards Act of 1976 despite statute's silence concerning retroactive effect); Rainey v. Jackson State College, 551 F.2d 672, 676 (5th Cir. 1977) (citing *Bradley*, court applies Civil Rights Attorney's Fees Awards Act of 1976 retroactively because no manifest injustice or indication of contrary legislative intent); Keyes v. School Dist., 439 F. Supp. 393, 401 (D. Colo. 1977) (relying on *Bradley*, court applies Civil Rights Attorney's Fees Awards Act of 1976 retroactively); Buckton v. National College Athletic Ass'n, 436 F. Supp. 1258, 1262 & n.10 (D. Mass. 1977) (under *Bradley*, court permits application of Civil Rights Attorney's Fees Awards Act of 1976 to fees incurred prior to Act's effective date).

cases. Most of the courts interpreting the EAJA have also cited *Bradley* as direct support for retroactive application of the Act.[122]

In *Bradley* the district court awarded more than $56,000 in attorneys' fees and expenses to plaintiffs, parents and guardians of black schoolchildren, who had brought suit to force compliance with the Supreme Court's prior desegregation decisions.[123] The district court based the award on its equity powers.[124] The United States Court of Appeals for the Fourth Circuit reversed because no statutory basis for the fee award had existed when the award was made.[125] Although section 718 of the Education Amendments of 1972,[126] granting federal courts the authority to award attorneys' fees in school desegregation cases,[127] had become effective before the Fourth Circuit's ruling, the court held that only fees incurred after the statute's effective date were compensable.[128]

A unanimous Supreme Court vacated the Fourth Circuit's ruling.[129] Justice Blackmun, writing for the Court, anchored his decision to apply section 718 retroactively in a principle first stated by Chief Justice John Marshall in 1801.[130] In *United States v. The Schooner Peggy*,[131] Chief Justice Marshall wrote:

> [I]f subsequent to the judgment [of the trial court] and before the decision of the appellate court, a law intervenes and positively changes the rule which governs, the law must be obeyed, or its obligation denied. If the law be constitutional . . . I know of no court which can contest its obligation.[132]

Justice Blackmun held that in the absence of clear statutory direction or legislative history to the contrary, courts must apply new laws to pending cases, unless doing so would result in "manifest injustice."[133] The Court focused on three considerations to determine whether retroactive application of a new law might result in "manifest injustice": first, the nature and identity of the parties;

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122. *See, e.g.,* Nunes-Correia v. Haig, 543 F. Supp. 812, 816 (D.D.C. 1982) (*Bradley* supports allowing fee awards for legal services rendered before EAJA's effective date in cases pending on effective date); WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9, 12-13 (D. Conn. 1981) (*Bradley* supports conclusion that no manifest injustice would result from retroactively applying fee-shifting provision of National Historic Preservation Act, 16 U.S.C. § 470w-4 (Supp. V 1981), against federal government through EAJA); Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 n.5 (D.D.C. 1982) (retroactive application of EAJA consistent with interpretation given fee-shifting statute in *Bradley*).

123. *Bradley*, 416 U.S. at 699-702, 705-06.

124. *Id.* at 706.

125. *Id.* at 709. The Fourth Circuit reasoned that Congress' failure to provide specifically for attorneys' fees in desegregation cases prior to the enactment of the Education Amendments of 1972 indicated that Congress did not intend parties to recover fees. *Id.*

126. Pub. L. No. 92-318, tit. VII, § 718, 86 Stat. 235, 369 (codified at 20 U.S.C. § 1617 (1976) and repealed 1979).

127. *Id. See supra* note 117 (quoting relevant fee-shifting provision of Education Amendments of 1972).

128. *Bradley*, 416 U.S. at 709-10.

129. *Id.* at 724. Justices Marshall and Powell took no part in the consideration or decision of the case. *Id.*

130. *Id.* at 711-13. *Cf.* Hollingsworth v. Virginia, 3 U.S. (3 Dall.) 378, 382 (1798) (dismissing suit against state by citizen of another state, though suit brought before passage of eleventh amendment).

131. 5 U.S. (1 Cranch) 103 (1801).

132. *Id.* at 110.

133. *Bradley*, 416 U.S. at 711.

second, the nature of their rights; and, third, the nature of the impact of the change in law upon those rights.[134] The Court concluded that none of the considerations presented any obstacle to retroactive application of section 718 against a local public school board.[135] Similarly, application of the *Bradley* factors to litigation between the federal government and a private party under the EAJA demonstrates that no manifest injustice would result from awarding pre-Act fees in cases pending when the EAJA went into effect.

Examining the first consideration, Justice Blackmun noted that a chief concern in applying a new law retroactively is the danger of injustice in cases between private parties.[136] No such danger was present in *Bradley* because the schoolchildren plaintiffs were disadvantaged in protecting their interests against the local government because of the parties' disproportionate resources.[137] Similarly, EAJA cases involve plaintiffs suffering a disadvantage in their ability to protect themselves and their interests. In fact, the tremendous disparity between the resources of small businesses and other private parties and those of the federal government was one of the concerns that prompted passage of the Act.[138] Moreover, the *Bradley* Court discerned that the plaintiffs seeking desegregation of public schools had rendered a substantial service both to the school board and to the community at large.[139] Similarly, a party seeking fees under the EAJA renders substantial service both to the federal agency by bringing it into compliance with its statutory mandate and to the community by helping to secure freedom from unwarranted government regulation.[140] Therefore, both the disparity in resources between the government and private parties and the benefit rendered to the community by private litigants who contest unjustified government actions distinguish EAJA cases from those involving solely private parties.

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134. *Id.* at 717.

135. *Id.* at 721.

136. *See id.* at 718 (injustice could result from application of a new law to a pending case "in mere private cases between individuals") (quoting United States v. The Schooner Peggy, 5 U.S. (1 Cranch) 103, 110 (1801)).

137. *Id.* at 718 & n.25 (parties' resources disproportionate because defendant represented by city attorney's legal staff and retained counsel highly experienced in trial work).

138. *See, e.g.,* EAJA § 202(b), 5 U.S.C. § 504 note (CONGRESSIONAL FINDINGS AND PURPOSES) (Supp. V 1981) (standard for awards against federal government should be different from standard for awards against private litigants because of greater resources and expertise of United States); S. REP. No. 253, 96th Cong., 1st Sess. 1 (1979) (disparity between resources and expertise of individuals and their government magnify economic deterrents to contesting government action); 125 CONG. REC. 1,437 (1979) (statement of Sen. Domenici) (basic problem EAJA seeks to overcome is inability of many to combat "vast resources" of government).

139. *Bradley*, 416 U.S. at 718 (plaintiffs rendered substantial service both to school board by bringing it into compliance with its constitutional mandate and to community by securing benefits of nondiscriminatory school system).

140. In WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9 (D. Conn. 1981), the fee-shifting provision of the National Historic Preservation Act (NHPA), 16 U.S.C. § 470w-4 (Supp. V 1981), was applied retroactively against the federal government through the EAJA's provision allowing fee awards against the United States under the terms of any fee-shifting statute. The *WATCH* court held that applying the NHPA provision retroactively against the Department of Housing and Urban Development presented no threat of manifest injustice when the local community preservation group seeking pre-Act fees had performed a substantial service to the federal government and the community by protecting historic properties and ensuring that an urban renewal project was undertaken in a lawful manner. *Id.* at 12. *See also* 126 CONG. REC. S13,690 (daily ed. September 26, 1980) (statement of Sen. DeConcini) (individuals and small businessmen who challenge unreasonable government actions serve public policy and public purpose).

The *Bradley* Court's analysis of the second consideration, the nature of the rights affected by applying a new law retroactively, centered on the threat of manifest injustice when a new law either deprives a person of or infringes a right that has matured or become unconditional.[141] Because the defendant school board had no "matured or unconditional right" to the tax money that would pay the plaintiffs' attorneys' fees, the *Bradley* Court held that there was no threat of injustice in requiring the school board to pay fees incurred before the effective date of section 718.[142] Again, *Bradley*'s reasoning is analogous to an analysis of the EAJA. Like the school board in *Bradley*, federal agencies have no "matured or unconditional" right to the funds allocated to them by the taxpayers.[143] Therefore, retroactive application of the EAJA would not pose a threat of manifest injustice because of the nature of the rights affected.

The final factor the *Bradley* Court considered was the impact of the change in the law on existing rights or the possibility that new and unanticipated obligations could be imposed upon a party without notice or an opportunity to be heard.[144] The Court held that retroactive application of section 718 did not alter the school board's constitutional responsibility to provide pupils a nondiscriminatory education.[145] Likewise, retroactive application of the EAJA would not result in increased burdens to the federal agencies because the Act allows fee awards only when the federal action is not "substantially justified" or falls within one of the narrow common law exceptions to the American rule.[146] The EAJA thus reflects the notion that if an agency cannot substantially justify its position, then it had no business litigating it. The Act does not change the obligation of federal agencies to comply with federal statutes by performing their duties in a fair and evenhanded fashion.[147] The EAJA simply penalizes agencies that fail to do so.

The same reasoning that persuaded the Supreme Court to apply section 718 of the Education Amendments retroactively thus supports retroactive application of the EAJA. No "manifest injustice" results from allowing awards of pre-Act fees in cases still pending on the EAJA's effective date. Particularly in light of those purposes of the Act that would be frustrated by refusing to apply

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141. *Bradley*, 416 U.S. at 720.

142. *Id.*

143. *See* Nunes-Correia v. Haig, 543 F. Supp. 812, 816 (D.D.C. 1982) (as in *Bradley*, only right affected by applying EAJA retroactively is government's interest in its own sovereign immunity; therefore, allowing awards of pre-Act fees "hardly constitutes" manifest injustice); WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9, 12 (D. Conn. 1981) (*Bradley* reasoning that school board had no unconditional right to public funds "particularly apposite" because urban renewal agency in this case has no unconditional right to public funds under NHPA or EAJA); *cf.* Hill v. United States, 571 F.2d 1098, 1102 (9th Cir. 1978) (if only interest impaired by voluntary congressional waiver of federal soveriegn immunity is that of government itself, no manifest injustice results when applying amendment to statute retroactively).

144. *Bradley*, 416 U.S. at 720-21.

145. *Id.* at 721.

146. *See supra* notes 22-31 and accompanying text (standards for fees awards against United States under EAJA).

147. *See* WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9, 12-13 (D. Conn. 1981) (application of attorneys' fees amendment to NHPA against United States under EAJA cannot be viewed as changing obligation of federal defendants to comply with federal statutes in undertaking urban renewal projects).

the EAJA retroactively,[148] the absence of any manifest injustice further strengthens the conclusion that allowing awards of pre-Act fees in pending cases is a fair interpretation of the Act. This interpretation thus meets the standard for government liability fashioned by the Supreme Court in *United States v. Testan*.[149]

Both the federal district court in *Allen v. United States*[150] and the Justice Department, however, have distinguished cases arising under the EAJA from *Bradley*.[151] Unlike EAJA cases that deal solely with federal agencies, *Bradley* dealt with the application of a fee-shifting provision to a local school board.[152] Thus, as the *Allen* court and the Justice Department have recognized, the *Bradley* Court did not need to consider the issue of federal sovereign immunity.[153] But in determining that *Bradley* is "distinguishable from and irrelevant to" a construction of the EAJA,[154] the *Allen* court and the Justice Department have ignored the fact that section 718 of the Education Amendments of 1972, which was construed in *Bradley*, allowed fee-shifting in suits against the United States as well as against state and local governments for violations of various civil rights statutes.[155] The differences between *Bradley* and cases construing the EAJA are therefore overstated. The *Bradley* Court did not distinguish between section 718's application to state, local, and federal governments. Nor would such a distinction be logical in light of the absence of any such distinction under the statute.

Furthermore, the *Bradley* Court did not ground its holding on an interpretation of section 718 of the Education Amendments alone. It also based its decision on the general principle that unless a statute or its legislative history specifically provides for prospective effect only or unless manifest injustice would result, "a court is to apply the law in effect at the time it renders its decision."[156] By its own terms, therefore, *Bradley* extends retroactive application beyond both section 718 and fee-shifting statutes generally to any new statute. The three-part *Bradley* test is therefore relevant to an evaluation of the EAJA.

There is a distinction, nonetheless, between statutes allowing fee-shifting

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148. *See supra* notes 54-69 and accompanying text (discussing why retroactive application required to further congressional intent).

149. 424 U.S. 392 (1976). *See supra* notes 40-41 (discussing *Testan* standard).

150. 547 F. Supp. 357 (N.D. Ill. 1982).

151. *See Allen*, 547 F. Supp. at 361-62 (*Bradley* irrelevant to and distinguishable from case involving retroactive application of EAJA because Act involves fee award against federal government); AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 49 (*Bradley* inapplicable to interpretation of EAJA because Act involves considerations of sovereign immunity not dealt with in *Bradley*).

152. *Allen*, 547 F. Supp. at 361-62; *see* AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 49 (*Bradley* distinguishable because did not involve award of fees against United States).

153. *Allen*, 547 F. Supp. at 361; AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 48-49.

154. *Allen*, 547 F. Supp. at 361-62; AWARD OF ATTORNEY FEES UNDER EAJA, *supra* note 18, at 49.

155. *See supra* note 117 (text of relevant section of Education Amendments of 1972).

156. *Bradley*, 416 U.S. at 711. The *Bradley* Court also expressly rejected the contention of several lower courts that a change in the law is applied retroactively to pending cases only when retroactivity is the "clear and stated intention of the legislature." *Id.* at 715 & n.20 (rejects Fourth and Fifth Circuit decisions holding that Congress' failure to clearly indicate intent to have statute apply retroactively precludes application of § 718 to pre-Act fees in pending cases). *See also* Rainey v. Jackson State College, 551 F.2d 672, 676 (5th Cir. 1977) (*Bradley* directly supports retroactive application of Civil Rights Attorney's Fee Awards Act of 1976 because decision not grounded on specific consideration of § 718, but on general principle favoring retroactive application of new laws to pending cases).

against state governments and those allowing it against the federal government. Because waivers of state sovereign immunity against attorneys' fees need not be explicit,[157] cases awarding fees retroactively against state governments do not provide direct support for a retroactive interpretation of the EAJA.[158] But cases dealing solely with waivers of state sovereign immunity against attorney's fees are still relevant to a consideration of the EAJA. When passing the Act Congress was well aware of prior court decisions on fee-shifting[159] and relied on them to define various terms in the Act.[160] Since *Bradley*,

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157. *See* Quern v. Jordan, 440 U.S. 332, 344-45 & n.16 (1979) (express statement by Congress unnecessary to override state sovereign immunity against award of expenses including attorneys' fees when statute's history and purpose require liability for such expenses); Hutto v. Finney, 437 U.S. 678, 696-97 (1978) (Congress may amend definition of costs assessed against state litigant without expressly abrogating state's eleventh amendment immunity). For a discussion of the history of the eleventh amendment immunity as a bar to state liability in federal courts, see Note, *Civil Rights Suits Against State and Local Governmental Entities and Officials: Rights of Action, Immunities, and Federalism*, 53 S. CAL. L. REV. 945, 1075-87 (1980).

158. The difference between state and federal sovereign immunity as barriers to fee-shifting is based largely on the historically different treatment of federal and state parties in federal courts for awards of litigation costs. Federal courts traditionally have had the authority to award litigation costs against state governments regardless of state sovereign immunity. *See* Hutto v. Finney, 437 U.S. 678, 695-96 (1978) (Court's awarding of costs against states goes back to 1849; federal courts may treat states like any other litigant when assessing costs and therefore may amend definition of costs assessable against state litigant to include attorneys' fees without expressly abrogating state eleventh amendment immunity); *cf.* NAACP v. Civiletti, 609 F.2d 514, 519-20 (D.C. Cir. 1979) (although absence of explicit statutory waiver no obstacle to fee award against states, express waiver required to award fees against federal government because no long tradition of awarding costs against United States), *cert. denied*, 447 U.S. 922 (1980). Federal courts have not, however, had any power in the absence of an express statutory waiver of sovereign immunity to award litigation costs against the federal government. Moreover, Congress has always closely regulated the definition of such costs and typically has excluded fees and expenses of attorneys. *See* 28 U.S.C. § 2412(a) (Supp. V 1981) (except as otherwise specifically provided by statute, courts may award prevailing party's costs but not attorneys' fees and expenses); *see also* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 267-68 (1975) (section 2412 on its face bars attorneys' fees awards, which must be expressly provided for by statute); NAACP v. Civiletti, 609 F.2d 514, 519 (D.C. Cir 1979) (section 2412 explicitly requires express abrogation of immunity), *cert. denied*, 447 U.S. 922 (1980).

At least one court, however, has determined that the EAJA has removed the presumption of federal sovereign immunity against an award of attorneys' fees not expressly authorized by statute and substituted for it a new presumption with a precisely opposite effect. WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9 (D. Conn. 1981). The *WATCH* court noted that 28 U.S.C. § 2412(b) gives courts discretion to award fees against the federal government to the same extent that any other party would be liable under the common law or existing statutes unless expressly *prohibited* by statute. *Id.* at 13-14. The court neglected, however, to note that section 2412(a), a provision antedating the EAJA and embodying the old presumption, continues unchanged by the EAJA. *See supra* note 14 and accompanying text (describing § 2412(a) and its continued vitality). Section 2412(a) bars awards of attorneys' fees against the United States "except as otherwise specifically provided by statute." 28 U.S.C. § 2412(a) (Supp. V 1981). Although there is considerable legislative history in favor of a broad interpretation of § 2412(b), it is unclear which presumption should guide the courts. *See, e.g.*, H.R. REP. NO. 1418, 96th Cong., 2d Sess. 9, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4987 (EAJA amends section 2412 to permit awards of attorneys' fees against United States to same extent fees may be awarded in cases involving other parties; at minimum, United States should be held to same standards in litigating as private parties); 126 CONG. REC. S13,874-75 (daily ed. Sept. 30, 1980) (statement of Sen. DeConcini) (under EAJA, U.S. liable for attorneys' fees under both common law and statutory exceptions to American rule unless statute expressly provides otherwise; conference report reflects belief that, at minimum, United States should be held to same standards in litigating as private parties).

159. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1159 n.4 (N.D. Ill. 1982) (presumption that Congress familiar with pertinent case law more than justified by repeated references in EAJA's legislative history to Civil Rights Attorney's Fees Awards Act of 1976). The EAJA's legislative history indicates that the stringent standard of conduct required of the government under the EAJA was imposed in reponse to the *Alyeska Pipeline* decision, which had limited the circumstances

courts have uniformly held that awards in pending cases may include all fees incurred since the action was initiated, regardless of whether the defendant is a state or the United States.[161] In light of the uniform retroactive application of fee-shifting statutes to pending cases, Congress' use of "pending" to define the cases affected by the EAJA provides direct support for retroactive application of the Act.[162]

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under which courts could award fees. H.R. REP. NO. 1418, 96th Cong., 2d Sess. 6, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4985. Furthermore, Congress was clearly aware of the barrier sovereign immunity had posed to fee awards under earlier statutes, such as the Civil Rights Attorney's Fees Awards Act of 1976, which courts had held did not provide a sufficiently express waiver of federal sovereign immunity. *See House Judiciary Hearings*, *supra* note 55, at 1 (statement of Sen. Kastenmeier) (since passage of Civil Rights Attorney's Fees Awards Act of 1976, Congress made aware that United States, as sovereign, generally not liable for attorneys' fees even under common law bad faith exception).

160. House and Senate committee reports on the Act refer to the debate over which standards of conduct to adopt for awarding fees against the government under the EAJA. The reports discussed one standard devised by the Supreme Court in Newman v. Piggie Park Enterprises, Inc., 390 U.S. 400 (1968) (per curiam). That standard effectuated the fee-shifting provision of title II of the Civil Rights Act of 1964, 42 U.S.C. § 2000a-3(b) (1976), by allowing prevailing plaintiffs to recover fees unless special circumstances would render an award unjust. *Piggie Park*, 390 U.S. at 402 (court formulates new standard because bad faith standard too restrictive to effectively encourage individuals injured by racial discrimination to seek judicial relief). The reports also discussed a separate, more restrictive standard delineated by the Supreme Court for recovery by prevailing defendants seeking fees under the fee-shifting provision of title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(k) (1976), in Christiansburg Garment Co. v. EEOC, 434 U.S. 412 (1978). The Court held that because prevailing defendants in a title VII action do not further congressional policy, fees should be awarded only when the plaintiff's action was "frivolous, unreasonable, or without foundation." *Id.* at 421. *See* H.R. REP. No. 1418, 96th Cong., 2d Sess. 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4989; S. REP. No. 253, 96th Cong., 1st Sess. 6 (1979). The House and Senate committees rejected both standards, the former because it would allow fee awards in too many circumstances and the latter because fees would be awarded too infrequently. *See* H.R. REP. No. 1418, 96th Cong., 2d Sess. 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4989 (substantial justification standard balances executive branch's constitutional obligation to faithfully execute laws against public interest in encouraging parties to vindicate rights); S. REP. No. 253, 96th Cong., 1st Sess. 6 (1979) (*Piggie Park* standard inappropriate due to potential chilling effect on reasonable government enforcement actions; *Christiansburg Garment* standard would not overcome "strong disincentives" to litigate against United States).

The EAJA's legislative history also expressly directs courts to interpret the term, "prevailing party," consistently with prior judicial construction. *House Judiciary Hearings*, *supra* note 55, at 15, 21-22 (statement of Sen. DeConcini); H. REP. No. 1434, 96th Cong., 2d Sess. 15, 21-22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 5003, 5010-11 (Conference Report); H.R. REP. No. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990; S. REP. No. 253, 96th Cong., 1st Sess. 7 (1979); 126 CONG. REC. H9,999 (daily ed. Sept. 30, 1980) (statement of Committee of Conference); 126 CONG. REC. S13,874 (daily ed. Sept. 30, 1980) (statement of Sen. DeConcini).

Bradley was among the cases the legislative history directed the courts to follow in interpreting the EAJA's terms. *See* H. REP. No. 1434, 96th Cong., 2d Sess. 15, 21-22, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 5003, 5010-11 (Conference Report) (report, citing *Bradley*, deems party prevailing even if he does not ultimately prevail on all issues); H.R. REP. No. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990 (same); S. REP. No. 253, 96th Cong., 1st Sess. 7 (1979) (same).

161. *See supra* notes 118-21 and accompanying text (fee-shifting provisions of Education Amendments of 1972, Voting Rights Act of 1965, Freedom of Information Act, Civil Rights Attorney's Fee Awards Act of 1976 applied retroactively).

162. The Supreme Court has noted that statutes containing similar language and sharing a "common *raison d'etre*" should be interpreted in the same manner. Northcross v. Memphis Bd. of Educ., 412 U.S. 427, 428 (1973) (per curiam). Because courts have interpreted attorneys' fees provisions to apply retroactively in pending cases and legislative history indicates that Congress was familiar with the pertinent case law, use of the word "pending" in the EAJA supports a waiver of sovereign immunity against pre-Act fees incurred in cases pending on the Act's effective date. *See* Underwood v. Pierce, 547 F. Supp. 256, 261 n.7 (C.D. Ca. 1982) (because courts have interpreted attorneys' fees provisions that apply to pending cases to allow fees for work performed before an act's effective date, because Congress is presumed to be familiar with pertinent case law, and because statutes containing similar language

The strongest support for the retroactive application of the Act is judicial interpretation of other statutes that assess attorneys' fees solely against the federal government. The same federal sovereign immunity arguments that have been raised against retroactivity under the EAJA confronted courts construing the fee-shifting provision of the Freedom of Information Act (FOIA).[163] In language similar to that found in the EAJA, the FOIA fee-shifting provision allows courts to hold the United States liable for attorneys' fees in any case in which the complainant has "substantially prevailed."[164] The FOIA's attorneys' fees provision, like the EAJA's, is silent about the government's retroactive liability for a prevailing party's fees. Like the EAJA, moreover, the FOIA provides no statutory direction or specific legislative history on its application to pre-Act fees in cases pending on the provision's effective date.[165] But because Congress intended that courts interpreting the FOIA look to the existing case law to determine when a fee award is appropriate,[166] courts faced with questions of the Act's retroactivity freely relied upon existing case law that had decided retroactive application of other attorneys' fees statutes. Recognizing that precedent overwhelmingly supported the award of all fees incurred in pending cases, courts have applied the FOIA attorneys' fees provision retroactively.[167]

The argument for retroactive application of the EAJA is even stronger. Like the FOIA, the EAJA's legislative history directs courts to interpret the Act's terms consistently with the case law that has developed under other fee-shifting statutes.[168] Courts construing fee-shifting statutes against both state governments and the United States have uniformly followed *Bradley* in allowing fee awards for all legal work performed in cases "pending" on the effective dates of those provisions.[169] But unlike the FOIA and other fee-shifting provi-

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and sharing common raison d'etre should be interpreted *pari passu*, Congress waived sovereign immunity for work performed on pending cases before EAJA's effective date).

163. 5 U.S.C. § 552(a)(4)(E) (1976).

164. *Compare id.* (under FOIA, "The court may assess against the United States reasonable attorney fees and other litigation costs reasonably incurred in any case under this section in which the complainant has substantially prevailed") *with* 5 U.S.C. § 504(a)(1) (Supp. V 1981); 28 U.S.C. § 2412(d)(1)(A) (Supp. V 1981) (under EAJA, prevailing parties' fees may be awarded unless government can show position "substantially justified" or that "special circumstances" exist making an award unjust).

165. *See* Cuneo v. Rumsfeld, 553 F.2d 1360, 1366-67 (D.C. Cir. 1977) (FOIA provision silent on issue of retroactivity, and legislative history merely directs courts to consider existing case law on appropriate award of attorneys' fees).

166. *See* H.R. REP. NO. 1380, 93d Cong., 2d Sess. 10, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 6267, 6288 (statutory criteria for court award of attorneys' fees and litigation costs eliminated in conference as unnecessary because existing body of law on award of attorneys' fees recognizes such criteria); *see also* Cuneo v. Rumsfeld, 553 F.2d 1360, 1366-67 (D.C. Cir. 1977) (FOIA's legislative history reveals Congress intended courts look to existing body of law on award of attorneys' fees to determine whether award appropriate).

167. *See* Cuneo v. Rumsfeld, 553 F.2d 1360, 1367 (D.C. Cir. 1977) (substantial weight of precedent indicates that right to attorneys' fees controlled by law in force at time action is terminated not law at time of commencement; court awards FOIA fees retroactively); *see also supra* notes 118-21 and accompanying text (cases supporting retroactive application of various fee-shifting statutes).

168. *See supra* note 160 and accompanying text (EAJA's legislative history directs courts to construe EAJA's terms consistently with existing case law).

169. *See supra* notes 118-21, 167 and accompanying text (discussing uniform retroactive application of prior statutes allowing fee-shifting against state and federal governments).

Courts construing the EAJA have also recognized the substantial weight of judicial authority in favor of its retroactive application. *See* National Lawyers Guild v. Attorney General, 94 F.R.D. 616, 620

sions such as the Civil Rights Attorney's Fees Awards Act of 1976[170] and the Education Amendments of 1972[171] that are completely silent about their application to pending cases, the EAJA explicitly authorizes awards in cases pending on October 1, 1981.[172] Yet courts have applied other fee-shifting provisions retroactively in the face of this complete silence.[173] Therefore, the EAJA, with its explicit application to pending cases, provides a more persuasive argument for retroactive application than do the fee-shifting provisions in the FOIA against the federal government and in other statutes against state and local governments.[174]

E. THE EAJA PROVIDES ITS OWN MECHANISMS TO PROTECT THE GOVERNMENT FROM UNFAIR RETROACTIVE FEE AWARDS

A judge need not refuse to apply the EAJA retroactively to avoid saddling the government with an unfair fee award. Under the EAJA, a judge can release the government from paying attorneys' fees not only when the government can show its position was "substantially justified" but also when "special circumstances" exist that make an award unjust.[175] By providing this "safety valve," Congress intended to protect the government from paying fees when an agency unsuccessfully advances a novel theory in good faith or when other equitable considerations indicate that a particular prevailing party does not deserve a fee award.[176]

Because the government was not required before the Act to prove that its position was substantially justified, a number of special circumstances could arise in which equitable considerations might persuade a court to deny an award under the EAJA. For example, in a suit that had lasted a number of years before the Act's passage, the government might have particular difficulty

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(S.D.N.Y. 1982) (citing cases located by parties and court on retroactive application of EAJA that "squarely and uniformly support" recovery of fees for work performed before effective date).

170. 42 U.S.C. § 1988 (Supp. IV 1980).

171. Pub. L. No. 92-318, tit. VII., § 718, 86 Stat. 369 (codified at 20 U.S.C. § 1617 (1976) and repealed 1979).

172. EAJA § 208, 5 U.S.C. § 504 note (EFFECTIVE DATE) (Supp. V 1981), 28 U.S.C. § 2412 note (EFFECTIVE DATE OF 1980 AMENDMENT) (Supp. V 1981). In Hutto v. Finney, 437 U.S. 678 (1977), the Supreme Court applied the Civil Rights Attorney's Fees Awards Act of 1976 (CRAFAA), 42 U.S.C. § 1988 (Supp. IV 1980), retroactively, based on Congress' direction in the Act's legislative history that CRAFAA apply to "all cases pending on the date of the enactment." *Hutto*, 437 U.S. at 695 n.23. That the EAJA includes language virtually identical to the phrase *Hutto* relied on is persuasive evidence of Congress' intent to have the EAJA, like the CRAFAA, apply to pre-Act fees. *See* Grand Blvd. Improvement Ass'n v. Chicago, 553 F. Supp. 1154, 1159 n.4 (N.D. Ill. 1982) (Congress followed effective date provision with "pending case" language precisely to avoid problem addressed in *Bradley* by expressing in statute what had only been in legislative history of CRAFAA).

173. *See supra* notes 118, 121 (courts construing Education Amendments of 1972 and Civil Rights Attorney's Fees Awards Act of 1976).

174. *See* Nunes-Correia v. Haig, 543 F. Supp. 812, 816 (D.D.C. 1982) (unlike other fee-shifting statutes applied retroactively, EAJA explicitly authorizes awards in cases pending on effective date, so case for retroactive application even stronger).

175. 5 U.S.C. § 504(a)(1) (Supp. V 1981); 28 U.S.C. § 2412(d)(1)(A) (Supp. V 1981) (court or agency shall award to prevailing party fees and expenses unless government's position was "substantially justified" or "special circumstances" make award unjust).

176. *See* H.R. REP. NO. 1418, 96th Cong., 2d Sess. 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990 (special circumstances provision acts as "safety valve" to ensure government not deterred from advancing in good faith novel but credible extensions of law and gives court discretion to deny awards when equitable considerations indicate award should not be made).

demonstrating that its position was substantially justified at some earlier stage of litigation. A change in agency personnel might make it impossible for the government to demonstrate its good faith in advancing a new theory that was ultimately rejected by the court. At least one court has denied an award under the special circumstances exception to the EAJA, ruling that the court's own lengthy delay in reaching a decision made a fee award unfair when a prompt decision would have resolved the case before the Act's effective date.[177]

The EAJA provides another mechanism to avoid saddling the government with unfair fee awards that is particularly relevant to retroactivity cases. The Act directs judges to exercise their discretion to reduce or eliminate an award when a prevailing party "unduly or unreasonably protracted final resolution" of the matter.[178] In a case involving many years of attorneys' fees, a court ought to inquire carefully into the government's and the private litigant's relative responsibilities for delaying the suit's resolution.

Moreover, as *Bradley* implicitly recognized, situations might arise in which retroactive application of a fee-shifting statute would produce manifest injustice.[179] Because the majority of cases will present no such injustice, judges generally should apply the Act retroactively. When a threat of manifest injustice surfaces, however, both *Bradley* and the provisions of the EAJA itself provide mechanisms for avoiding inequitable results without barring retroactive application of the Act in every case.

CONCLUSION

Waiver of federal sovereign immunity against pre-Act fees in cases pending on the EAJA's effective date is clearly a fair interpretation of the Act in light of the statute's language, legislative history, and cost estimates, and judicial precedent. Applying the EAJA to pre-Act fees not only presents no threat of "manifest injustice," the *Bradley* Court's test for retroactive application, but is required to further Congress' express purposes in passing the Act. Retroactivity therefore satisfies the "fair interpretation" standard of *Testan* for showing a waiver of federal sovereign immunity. Any other construction of the Act is directly contrary to both the Supreme Court's holding in *Bradley* and lower court interpretations of virtually every other fee-shifting statute passed by Congress within the last two decades.

Congress viewed any expense incurred by private citizens contesting arbitrary and unjustified government actions as an unfair burden on both the individual bringing suit and the private economy.[180] If the Act is not accorded

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177. The first report from the Director of the Administrative Office of the United States Courts on expenses under the EAJA includes a short analysis of cases in which fees were denied. According to the report, three of the petitions for fees filed under the EAJA were denied because special circumstances existed that would have made an award unjust. *See* REPORT OF ADMINISTRATIVE OFFICE, *supra* note 69, at 2 (one court denied fee award holding that if court had acted in timely manner case would not have been pending on Act's effective date).

178. 5 U.S.C. § 504(a)(3) (Supp. V 1981); 28 U.S.C. § 2412(d)(1)(C) (Supp. V 1981).

179. *See supra* notes 133-45 and accompanying text (discussing *Bradley*'s "manifest injustice" exception).

180. *See* 126 CONG. REC. H10,013 (daily ed. Sept. 30, 1980) (statement of Rep. Boner) (billions of dollars that are spent each year by small business community in "war" against government overregulation and "bureaucratic harassment" can be used better by small business in creating jobs).

retroactive application many parties who prevail against unwarranted government actions will not be compensated for a majority of their attorneys' fees. Had the court in *Nunes-Correia*, for example, refused to award pre-Act fees, only thirty-eight days of attorneys' fees would have been allowed in the plaintiff's seven-year suit to restrain enforcement of State Department regulations that the court ultimately found arbitrary and without any reasonable basis in law.[181] Congress designed the EAJA to help out the "little guy," and the statute should not be construed to frustrate that purpose.

David P. Donovan

181. *See* Nunes-Correia v. Haig, 543 F. Supp. 812, 813-14 (D.D.C. 1982). Other cases illustrate similar surprising results if the Act is not given retroactive application. *See* Allen v. United States, 547 F. Supp. 357, 360 (N.D. Ill. 1982) (court's refusal to allow award of pre-Act fees bars all but one half-hour of plaintiff's attorneys' fees incurred in action to recover overpaid taxes and abate penalty assessments); Costantino v. United States, 536 F. Supp. 60, 63-64 (E.D. Pa. 1981) (if court had refused retroactive application in action to recover overpaid taxes only $50 of $678.75 in fees would have been awarded); WATCH (Waterbury Action to Conserve Our Heritage Inc.) v. Harris, 535 F. Supp. 9, 11 (D. Conn. 1981) (if court had refused retroactive application in suit brought in 1978 to prevent violation of National Historic Preservation Act, only fees incurred on motion for attorneys' fees during final month of suit would have been awarded).